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SILVER PRICES AND THE ADEQUACY OF FEDERAL ACTIONS IN THE MARKETPLACE, 1979–80

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

NINETY-SIXTH CONGRESS

SECOND SESSION

MARCH 31; APRIL 14, 15, 29, 30; MAY 2 AND 22, 1980

Printed for the use of the Committee on Government Operations

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SILVER PRICES AND THE ADEQUACY OF FEDERAL ACTIONS IN THE MARKETPLACE, 1979–80

MONDAY, MARCH 31, 1980

House of Representatives,
Commerce, Consumer,
and Monetary Affairs Subcommittee
of the Committee on Government Operations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 2247, Rayburn House Office Building, Hon. Benjamin S. Rosenthal (chairman of the subcommittee) presiding.

Present: Representatives Banjamin S. Rosenthal, Eugene V. Atkinson, Elliott H. Levitas, and Joel Deckard.

Also present: Peter S. Barash, staff director; Barbara Timmer, counsel; Eleanor M. Vanyo, secretary; and Jack Shaw, minority professional staff, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN ROSENTHAL

Mr. **Rosenthal**. The subcommittee will be in order.

Today's hearing by the Commerce, Consumer, and Monetary Affairs Subcommittee will examine the reasons for and the Federal response to last week's collapse in the silver markets and the impact of that event on the securities industry and the stock markets.

We are deeply concerned that the activities of a handful of commodity speculators could have such a profound effect on our Nation's financial markets. We are alarmed that the Federal regulatory mechanism was unable to prevent this extremely dangerous economic situation.

The Congress must know how last week's events came to pass; whether, through more diligent regulation, they could have been averted; and what must be done now to prevent a recurrence in the future.

We have listed a whole series of questions—18 in all—for the Commodity Futures Trading Commission, and 7 for the Securities and Exchange Commission.

There are a number of questions that will follow from what I expect to be the testimony.

Rather than read these, I presume both of you are reasonably familiar and can deal with the questions, acknowledging that you have only had a few minutes to examine them, but I assume your firsthand knowledge of events qualifies you to respond forthrightly and succinctly.

READEX FICHE

If, in fact, any of these questions, or more correctly their answers ought to be prudently delayed because of market sensitivity, we have scheduled continuation of these hearings for Monday and Tuesday, April 14 and 15, and hopefully stabilization will have occurred by that time.

These questions will be inserted in the record at this point. Without objection, so ordered.

[The questions follow:]

This hearing seeks answers to the following questions from the Commodity Futures Trading Commission:

(1) What happened in the silver markets to trigger last week's collapse? Is it true, as reported, that a handful of speculators cornered or attempted to corner the silver markets? How much of these markets did they control?

(2) When and how did the CFTC first learn that there were potential problems in the silver futures market? What was the nature of these problems?

(3) What specific regulatory responses were taken by the Commission when it learned of problems in the silver futures market? Did the Commission communicate with silver speculators, with the appropriate commodity exchanges and with the responsible Federal agencies about this problem? When did it do so and with what specific results?

(4) Who called the meeting last Wednesday with Federal Reserve Chairman Volcker? Why was the meeting convened? Who was present? What was discussed? What was decided? Are other meetings scheduled and for what purpose?

(5) What actions did the New York COMEX and the Chicago Board of Trade take, prior to last week, that affected silver futures trading? Were these actions taken after specific consultation with the CFTC? Were the actions coordinated? What were the results?

(6) What actions did the COMEX and the Chicago Board of Trade take last week relative to the silver markets? Were these actions taken after specific consultation with the CFTC? What were the effects of these actions? Does the CFTC exercise effective control over the commodities exchanges?

(7) What are the CFTC's concerns, if any, over the impact of excessive speculation on the commodity futures markets? Have they been communicated to the Congress?

(8) What investigations or studies has the CFTC initiated in response to last week's events?

(9) Does the CFTC possess adequate authority and resources to prevent excessive speculation on the futures markets?

(10) What new regulatory authority does the CFTC favor to prevent a recurrence of last week's silver collapse? Can the Commission exercise adequate control over margin requirements and limits on amounts of any commodity a speculator can own?

(11) On March 28th, CFTC officials reportedly said they might act if brokerage firms appear to be having troubles that endangered their customers. The following day, Chairman Stone was quoted as saying that "government regulators would let a big broker like Bache go bankrupt rather than bail out silver speculators." Did the CFTC position change overnight? If so, why? Was Chairman Stone's position arrived at after consultation with Chairman Williams of the Securities and Exchange Commission, with the Federal Reserve, or with the Securities Investors Protection Corporation?

(12) Silver futures trading began on the COMEX in 1933, was suspended on August 9, 1934, and did not resume until June 1963. A four-day trading suspension took place in August 1971. In 1973, allegations were made that the Hunt brothers were disrupting the silver market. Should these suspensions of trading and the 1973 allegations have alerted the CFTC to more prompt action?

(13) Is there adequate coordination and cooperation among the various Federal regulatory agencies, specifically the CFTC, SEC and the Fed? Should an interagency council be established for monitoring financial markets as recommended by the General Accounting Office?

(14) How does inflation affect futures trading, including silver? Is there generally more speculative trading during periods of high inflation? Does excessive speculation as to silver and other futures affect the rate of inflation?

(15) Did the fall in silver futures affect futures prices in lievestock, grains, soybeans, copper, cotton, pork bellies and sugar? If so, how? Have hedging interests been hurt? Have commodities brokers suffered losses? Will there by continuing volatility in commodities?

(16) What impact did the Federal Reserve's latest series of interest rate boosts have on commodity futures speculation? Did the Fed's policies contribute to the current heavy liquidation of futures positions? Has the relationship between high interest rates and commodities speculation been discussed with Chairman Volcker? When and what effect?

(17) (a) Can the CFTC regulate or even monitor trading activity in any commodity without information on foreign traders?

(b) Chairman Stone recently visited Great Britain and returned to criticize the British refusal to cooperate with the CFTC. What is the CFTC currently doing about collecting foreign trader data? What are the dangers in the CFTC not having such data?

(18) Is futures trading moving out of the United States? Has the London market, without any of the limits imposed on trading here, had similar trading problems?

The Securities and Exchange Commission should respond to the following:

(1) How many brokerage firms are experiencing financial difficulty as a result of last week's collapse of the silver market? What steps is the SEC taking to deal with this situation?

(2) To what extent are the major Wall Street brokerage houses involved in futures trading? In what types of futures trading are they most heavily involved?

(3) Does the SEC have any concerns over the mixing of stock and futures trading by brokerage firms? If so, what types of regulatory changes might be indicated?

(4) Is the SEC satisfied with the effectiveness of the CFTC's general supervision of the futures markets and its specific regulation of the silver market?

(5) How serious is the SEC's recent criticism of the CFTC for permitting too rapid a growth in the trading of "exotic futures," such as Government bonds, home mortgages and other financial futures?

(6) Does the SEC concur with CFTC Chairman Stone's statement last week that he would let a big broker like Bache go bankrupt rather than suspend silver futures trading? Was the SEC consulted prior to this statement?

(7) Is the SEC satisfied with the present degree of coordination and cooperation among itself, the CFTC, the FED and the Treasury Department? If not, what steps will it recommend to improve the systematic exchange of information and policy views?

Mr. **Rosenthal**. Commissioner Stone and Chairman Williams, we are delighted that both of you could be here with us. We realize the imposition of the short notice and appreciate your cooperation.

If you could just go down the list as best you can and answer these questions, it would be very useful.

Mr. Stone?

STATEMENT OF JAMES M. STONE, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

Mr. **Stone**. Thank you, Mr. Chairman.

The first question asks for a summary of what happened to trigger the change in prices last week.

I would like, if I may, to step back for a moment and describe the overall situation that preceded last week's events.

We had seen, in the last year or so, and beginning several years before that, very large concentrations in the silver market, both in futures and in cash positions. The cash positions represent a particular concern because hoarding of physical commodities is essentially unregulated in the United States.

If someone, for example, were to buy all the Picasso paintings to force up the price and had the money to do so, he might well succeed. What we saw in the silver market was very largely a cash hoarding situation of that sort. A small number of people felt they had the resources to accumulate such vast amounts of silver as to be able to command a much higher price than existed in the market before.

That is the background of the situation.

Mr. **Rosenthal**. When did this begin, this cash hoarding?

Mr. **Stone**. It began as long ago as 5 years ago, and perhaps even longer.

Mr. **Rosenthal**. Essentially by the same people who were involved in last week's events?

Mr. **Stone**. Yes; they had very gradually at first and then more rapidly, accumulated tremendous amounts of the physical commodity.

Then last week a combination of circumstances led to a breaking in the price. The prices, as often happens in a hoarding situation, were forced up in anticipation that prices were going to continue to rise. When a break occurs that break can be very, very rapid.

The break occurred for several reasons. One of them is that there turned out to be a more physical supply of the metal than some of the speculators thought.

We began to see, for example, people turning in their home silverware. That added supply to the market than no one had been sure was there.

We also found——

Mr. **Rosenthal**. What percentage of supply did that turn into the market?

Mr. **Stone**. No one has accurate measurements of the cash market. There is no agency that regulates cash markets in commodities. We regulate future markets. The SEC regulates securities markets. But the actual physical commodities markets are essentially unregulated.

We have broad investigatory powers into those markets but very little action power. It would be very hard to measure exactly what the impact of the changes in supply would be.

But I can get you what figures are available for the record.

Mr. ROSENTHAL. Thank you.

Without objection, so ordered.

[The material follows:]

It is difficult to give any precise estimates of the amounts of refineable silver that has come into the market as a result of higher silver prices. The information we have on these fresh supplies shown in the table below is based on industry estimates which must be viewed as very imprecise. It is, however, the best information we have available.

Fresh supplies of silver potentially available for delivery this year as a result of higher prices by source:

	Million Ounces
Silver Coins	36
Jewelry and Indian Materials	18
Platware, other household silver and other silver refineables	36
Total fresh supplies of silver	90

Mr. STONE. In any case, there was a change in the supply conditions and also on the other side of that equation. It became more and more difficult for people to hold very long positions as interest rates went up and financing became more difficult to obtain.

Both of those things happened essentially at the same time—the supply of silver increased and it became harder to hold long positions.

For reasons that only the market knows, these forces came together at a particular point in time, approximately last Wednesday, and market movements were very rapid after that.

I think that is as much as I can give you right now on the first question.

The second question has to do with when the CFTC learned there were potential problems in the market and what the nature of the problems were. I think I have largely answered that already.

We became aware long ago that potential problems could be developing. But our concern from the beginning has been that those problems were more in the cash markets than in the futures markets. The futures markets, to some extent, did make it easier, however, for those cash market problems to occur.

Mr. **Rosenthal.** Did there become a time when you were aware that a handful of speculators were attempting to corner the market?

Mr. **Stone.** Certainly that suspicion grew and grew. It got to a point at which I would say most of us thought that was a real possibility.

Mr. **Rosenthal.** Can you give us some dates when you raised your level of concern or interest in this matter? When did you first begin talking about it as a potential threat?

Mr. **Stone.** It had been talked about years ago, but the threat became very clear at approximately the fall of last year, September to be specific?

Mr. **Rosenthal.** September 1979?

Mr. **Stone.** Yes, that is when the price began to move rapidly. That is when our concern magnified.

Mr. **Rosenthal.** Were you concerned at any point that a few speculators were cornering the market before the price began to move?

Mr. **Stone.** It would be very hard to have reached the conclusion that was occurring until the price began to move. That is one of the pieces of evidence taken into account.

The price will generally move as someone acquires those large positions. You cannot acquire the large positions you are talking about without moving prices.

Mr. **Rosenthal.** When did it become common knowledge that the Hunts were particularly concerned with amassing large interests in the silver market, both cash and futures?

Mr. **Stone.** I do not know when it became common knowledge, but I remember concern expressed in the newspapers at approximately the same time.

Mr. **Rosenthal.** When was the first time the Commission expressed at any of its meetings or public statements a concern or awareness?

Mr. **Stone.** The Commission does not make public statements on developments in markets. As I am sure you are aware, we are forbidden by Congress to discuss surveillance information.

Mr. **Rosenthal.** When did you first become interested?

Mr. **Stone.** As I said, it had been followed for years before I was with the Commission, but it became a subject of great concern in the fall as the price began to move and as those very large positions were acquired.

Mr. **Rosenthal.** Mr. Deckard?

Mr. **Deckard.** Thank you, Mr. Chairman.

Mr. Stone, how well are you able to monitor the so-called cash hoardings or the identity of the people involved, the amount of hoardings, and what options do you have available to prevent the kind of precipitous increases and decreases we have seen?

Mr. STONE. We have fairly good abilities to monitor the futures markets and to the extent that cash hoarding occurs through the futures markets, we can monitor it to some degree.

To the extent that it occurs in pure cash markets, it is very hard to monitor. We really do not have the tools for that. It is not clear that Congress has given anyone the authority to prevent a cash hoarding situation in a physical good.

Mr. ROSENTHAL. Do you have an opinion as to the Hunts' holdings—what percentage is in cash positions and what percentage was in futures?

Mr. STONE. I cannot discuss position information. That is forbidden by Congress.

Mr. ROSENTHAL. You are forbidden to make it public. It is not forbidden to give it to Congress.

Mr. STONE. It is not forbidden to give it to Congress. Our Commission has voted, with myself in the minority, I might add, to do that only upon subpena.

Mr. ROSENTHAL. We are going to deal with that as a separate issue.

Why not go on to No. 3?

Mr. STONE. Yes.

The specific regulatory response taken by the Commission date back to one that did not occur, that is, the Commission had decided in October 1977—considerably before I came on board—not to impose limits in the silver market.

The Commission did, however, as the questioning goes on to suggest, communicate its growing concern with those who held positions in the markets, with the commodities exchanges, and with the other responsible Federal agencies.

There was a considerable amount of communication on the subject and a considerable amount of concern expressed, ultimately resulting in the exchanges taking self-regulatory action to impose limits and raise margins.

Mr. ROSENTHAL. Please go ahead.

Mr. STONE. If I may move on to question four, that gets into last week's events.

Mr. ROSENTHAL. I want to understand your testimony, and there are reasons for the nature of my inquiry.

The Commission first became, that is, expressed a high level of concern in September 1979; is that your testimony?

Mr. STONE. Yes, sir.

Mr. ROSENTHAL. Prior to that, could you describe the attitude of the Commission toward the silver markets?

Mr. STONE. The Commission had been monitoring the silver markets on a regular basis more actively than many other commodities, so there was a higher level of concern than in some other commodities—most other commodities.

But it had not reached the point of deep concern that it reached in September.

Mr. ROSENTHAL. Had you done any investigatory work or authorized any investigations as of that point?

Mr. STONE. Yes, there had been several before that point.

Mr. ROSENTHAL. Are they presently in the files of the Commission, or in the possession of the Commission?

Mr. **Stone.** Yes.

Mr. **Rosenthal.** Please go on.

Mr. **Stone.** If I may go on to last week's events, you ask in question No. 4 about the meeting that was held on Wednesday with Federal Reserve Chairman Volcker. Yes, there was such a meeting on Wednesday.

Events broke very rapidly on Wednesday. There was very little notice to anyone that the price would break as suddenly as it did. We certainly did not predict a rapid break in price on Wednesday and I do not believe anyone else did. The market did not, or there would have been shorts in the market.

But the price did break rapidly on Wednesday morning. At that time I was testifying before Congress in the Senate. When I returned to my office there was a message to call Chairman Volcker at once. I did call him.

He summarized briefly for me what had happened in the morning. My own staff then was able to essentially tell me the same facts.

I went immediately to Chairman Volcker's office and present at that meeting——

Mr. **Rosenthal.** What time was that?

Mr. **Stone.** This had to be somewhere around 1:30, I would guess. But I am not certain of the exact time.

Present with us at various points during the day were Chairman Volcker; Anthony Solomon, the new Chairman of the Federal Reserve Bank of New York; Chairman Williams, and Deputy Secretary of the Treasury, Robert Carswell.

Mr. **Rosenthal.** That meeting went from 1:30 until approximately what time?

Mr. **Stone.** I think I got back at the office at about 6 p.m.

Mr. **Rosenthal.** Can you respond to the remainder of that question?

Mr. **Stone.** Yes; the remainder of that question has to do with what was discussed, what was decided, and whether there were other meetings scheduled.

There were many things discussed during that long period. The essence of it is that we were all exchanging facts; each of us had the staffs from our various offices working on collecting facts concerning what was happening and what the implications would be for other financial institutions as we looked at the commodities markets.

We were accumulating facts rapidly during the afternoon on Wednesday. We did not make any decisions at that time. In fact, we had a quorum of no official body there which could make a decision. We had the chairman of each body and none of the bodies themselves.

There were, after that, many other meetings and phone calls in the last few days. We have kept in constant touch in the early hours of the morning and late at night.

Mr. **Rosenthal.** How would you describe the tone or character of the meeting?

Mr. **Stone.** I would say the demeanor was calm, but that everybody had substantial concern.

The next question asks about actions that Comex and the Chicago Board of Trade took prior to last week.

Mr. ROSENTHAL. Let me ask just one other question on that subject.

Do you have any thoughts as to why Mr. Volcker called that meeting? Why was he the lead person to call that meeting as compared to you, Mr. Williams, or Mr. Carswell, or anyone else?

Mr. STONE. I think you would have to ask Chairman Volcker exactly why he placed the call.

Mr. ROSENTHAL. I am asking what your opinion is of why he called the meeting.

Mr. STONE. I do not like to guess at the reasons that other people do things, although I think it made sense for all of us to get together. I was not the one who initiated the meeting, in part, because I was up on the Hill at the time the events broke.

Mr. ROSENTHAL. Mr. Volcker would not have come to your meeting anyhow, would he?

Mr. STONE. We might have had the meeting at his office.

Mr. ROSENTHAL. You do not have any opinion as to why Mr. Volcker called the meeting?

Mr. STONE. We had numerous shared concerns. I think it made sense to have a meeting that involved the officials from the different agencies.

Mr. ROSENTHAL. What were your shared concerns?

Mr. STONE. The concern was that there could be a situation of financial panic which could affect not only the commodities markets but the stock market, and possibly financial institutions as well.

All of us wanted to avoid that. It was important that we have an interagency meeting; Chairman Volcker was the senior-most of all of us in that respect, and thus he called the meeting.

Mr. ROSENTHAL. Have you ever attended a meeting before senior agency people?

Mr. STONE. I have talked many times with Chairman Williams.

Mr. ROSENTHAL. With that number of principals or with those principals?

Mr. STONE. I do not think I have attended a meeting with those same principals before.

Mr. ROSENTHAL. Have you ever met Chairman Volcker before?

Mr. STONE. I had never met Mr. Volcker before. But I know Deputy Secretary Carswell and I knew Chairman Williams fairly well before that. I have had many meetings with him, as well as phone calls.

If I may, I would like to go to the next question.

It has to do with what actions Comex and the Chicago Board of Trade had taken prior to last week that affected silver trading and whether these actions were taken after specific consultation with the CFTC.

The answer to that is that I have a complex chronology of those actions taken by Comex and the Chicago Board of Trade which I can leave for the record for you. It is too long to read because it involves——

Mr. ROSENTHAL. It will be included in the record, without objection, at this time.

[The material follows:]

Chicago Board of Trade

Date of Action	Nature of Action	Status
9/5/79	Increase in price limits to $.20 if silver is under $9 and $.40 if it is over $9.	Approved as 5a(12)
9/18/79 11/29/79	Revise spread pricing rule to enable trading of spreads in otherwise locked markets; one leg must be priced in actual range, the other in the permissible range.	Approved as 5a(12)
10/5/79	Price limits = $.40 between $9 - $15 $.60 between $151 - $20 $.80 over $20	This was not an emergency, approved 5a(12).
10/25/79	Imposition of position limits; 600 net all months.	Approved as 5a(12)
1/22/80	Trading for liquidation only January, February and March 1980 silver: 25% per week.	Extension to 3/26, no 5a(12) pending.
1/25/80	Amendment to 1/22 order to permit day trading that would not add new positions.	Extension to 3/26, no 5a(12) pending.
2/27/80	Removal of the daily trading (price) limits for April 1980 silver, prior to April becoming the spot month.	Expires 4/2, no extension or 5a(12) pending.

CHICAGO BOARD OF TRADE
SILVER MARGINS

DATE	INITIAL	MAINTENANCE	HEDGE	RE:
9/5/79	1500	1000	1500	
9/6/79	2500	1750	1750	all open and new
9/19/79 open positions	4500	3000	1750	
9/19/79 (spot month)	$30,000	$20,000	$20,000	margin from prices of 9/6/79
9/19/79 new positions	$20,000	$15,000	$15,000	from level of 9/6/79
10/31/79	$15,000	$10,000	$10,000	New positions put on after 9/19/79
12/10/79	$9,000	$5,000	$5,000	new positions after 9/19/79 except spot month
1/8/80	$10,000	$7,000	$7,000	positions put on after 9/19/79 margins increase
1/18/80	$12,000	$8,000	$8,000	positions put on or after 9/19/79
3/15/5	9,000	6,000	6,000	positions on or after 9/19/79

Date	RE:	Action:	
	Straddle positions	Increased margin to $10,000	
	Pre-existing positions that were moved forward by stradding or legging in or out	Remains $5,000	
October 30, 1979 For all existing positions the effective date is November 12, 1979	Speculative positions	Total #	Margin
		1-100	$10,000
		101-250	20,000 (all contracts)
		251 or more	30,000 (all contracts)
	Spot month	Remains $50,000	
	Straddles	Total #	Margin
		1-1000	$100 (per month per straddle for all straddles)
		1001-2000	$200 (")
		2001 or more	$300 (")
February 4, 1980	Speculative positions	Total #	Margin
		1-100	$40,000 per contract
		101-250	$50,000 per contract
		251 or more	$60,000 per contract
	"Bona fide Hedge" positions New and Existing	Increased to $20,000	
	Spot month positions	Increased to $75,000	
	Straddle positions (when near month becomes spot month	Increased to $75,000	
March 27, 1980- April 1980	Spot month positions (speculative and hedge)	Reducted to $50,000	
	Hedge positions	Reduced to $15,000 per contract	
	Speculative Positions	Total #	Margin
		0-10	$25,000 (per contract)
		11-100	$35,000 (per contract
		101 and more	$40,000 (per contract)

Emergency Actions Taken by Comex With Respect to Trading in Silver Futures Contracts

Date of Action	Nature of Action	Status
9/4/79 as amended on 10/8/79	Increase in price limits; from $.20 to $.40; Adoption of variable price limits: after two consecutive limit days, variable limit equal 150% of original limit, if 150% limit is hit, the next day's limit is 200% or original limit. 1/	Approved as 5a(12)
1/7/80	Imposition of position limits and reporting requirements: Reporting requirements apply to FCM's carrying 100 or more contracts gross for each customer. Position limits are 2,000 net all months, and 500 gross in the two near months. No person may establish a new position in excess of 50 contracts in Jan and Feb. Rule is effective February 18, 1980, except that the limits for Jan and Feb are effective January 8, 1980. For accounts that are in excess of the aggregate limits, a 10% per month reduction of the excess must be made by January 31, 1981. Rule expires April 31, 1981.	Extension to 4/5, 5a(12) submitted.
1/21/80	Trading for liquidation only in all months; except: to allow new trading if done to effect delivery, to switch positions from one month to another, to exchange futures for physicals, to facilitate spreads where months are at limit.	Expired 2/20, superceded by 2/13 action.

1/ On November 27, 1979 the Commission approved, pursuant to section 5a(12), an increase in price limits from $.40 to $.50. This was not an emergency action.

Date of Action	Nature of Action	Status.
1/24/80	Amendment to liquidation only order to allow delivery against new positions in the spot month if it is impossible to switch out of those positions because deferred contracts are at limit.	Expired 2/23, superseded by 2/13 action.
1/31/80	Limited exception to liquidation only trading order for September 1980 and more distant contracts to permit new gross positions in all months up to 200 contracts, net positions in all months up to 50 contracts, and gross positions in any one month up to 50 contracts.	Expired 3/1, superseded by 2/13 action.
2/13/80	Terminate trading for liquidation only, permit acquisition of new positions up to 100 contracts gross in any one month and up to 400 contracts net in all months.	Extension to 5/13, no 5a(12) pending. Superseded by 3/26 action.
3/26/80	Permit acquisition of new positions up to 200 gross in any one month and 800 net in all months combined.	NO extension or 5a(12) pending.

Comex Revisions in Silver Margins

9/1/79 - 4/8/80

Date	**RE:**	**Action**
September 6, 1979	Existing and new positions	Original margin increased from $1,500 to $5,000
	When a month becomes the spot month	Additional margin of $250 is to be paid per contract.
	Straddle positions	No margin required
September 18, 1979	September 1979 (spot month) for all contracts obtained after 12:00 noon September 18, 1979	Increased margin to $50,000
	Straddle positions where one leg involves contract maturities of October 1979 through July, 1980	Margin increased to $5,000.
	Hedge positions	Margin set at $7,500
	Speculative positions	Margins set at $20,000
	Positions held before 12:00 noon on September 18, 1979 and that moved forward as a result of a straddle transaction or legging in or out.	$5,000 previous margin rate applies.
	Pre-existing straddle moved forward	No margin
September 28, 1979	October spot month and new and existing contracts upon becoming the spot month.	Margin requirement increased to $50,000.
October 26, 1979	All contracts except "bona fide hedge" transactions	Original margin increased to $30,000
	Hedge positions, spot month	Margin increased to $50,000
	Hedge positions, all other months	Margin increased to $7,500

Mr. **Rosenthal**. Could you summarize it? Specifically, were these actions coordinated and similar actions between the two exchanges?

And, were they done in consultation with the CFTC?

Mr. **Stone**. I will summarize the most important ones.

In January 1980, Comex imposed position limits and reporting requirements. In late January 1980, Comex declared trading would occur for liquidation only, which is an emergency action which lasted only for a short period of time.

The Chicago Board of Trade had imposed position limits in October of 1979 and, at the same time that Comex had trading for liquidation only, the Chicago Board of Trade did that as well for a short period.

The actions were not taken with specific permission of the CFTC, although I would guess—and here I can only guess—that they were taken largely in response to concern expressed by the CFTC about the developing problems in the silver market.

As to whether they were coordinated with one another, I doubt that they were coordinated with one another, but I have no way of knowing that for sure.

As for the results——

Mr. **Rosenthal**. The lack of coordination—is that a good or bad thing for the markets? Or has it no effect?

Mr. **Stone**. In this case it would be hard to find an effect. I think in general there is an argument for having coordination between the exchanges on important regulatory actions, more coordination than exists today.

In this case, I think the Chicago Board of Trade acted earlier and more decisively than Comex did. Had these actions been coordinated, there might not have been the shift of volume from Chicago to New York which perhaps was one of the contributing factors to the growth of the situation.

So, I think you have raised an important point there.

You have asked what effect these actions had. I think the effect of the actions was positive; that is, they made it more apparent to anyone looking that it would be difficult for the actions of a small group of speculators acquiring large positions to continue. The speculators were going to have to do some liquidating because of the position limits.

I would point out that one of the reasons that this action was taken by the exchanges and not by the CFTC at this time was that our statute—our congressional authorization—forbids us to impose retroactive position limits whereas the exchanges are permitted to impose retroactive position limits. They could, and did, impose limits that caused positions already in existence to be liquidated.

That was clearly one of the factors that later influenced the market in its downward direction, in my view.

The next questions are: What action did Comex and the Chicago Board of Trade take last week with respect to the silver markets? Were these actions taken after specific consultation with the CFTC and what were their effects?

Last week the Chicago Board of Trade's actions were principally actions to audit the solvency of their member firms. They had very intensive audits last week.

Mr. **Rosenthal.** How many of those firms did they audit?

Mr. **Stone.** I do not know the exact number. My director of trading and markets tells me 10 to 15 firms were audited.

Mr. **Rosenthal.** And how large were the cumulative assets of those firms?

Mr. **Stone.** Very large, but most of the assets of many of the firms were outside the commodities industry. Some of these were very large security firms.

Comex took the same sort of audit actions and also took actions to increase position limits and decrease margins.

The audit actions were taken in consultation with the CFTC. The margin and position limit actions of Comex last week were not. I might add that my personal view is that I have some doubt as to whether they were proper under the circumstances.

We will have to review that and, therefore, I cannot give you our final judgment now.

Mr. **Rosenthal.** Why do you think they were not the correct actions?

Mr. **Stone.** My personal view—and again I must emphasize that I am not speaking for the Commission when I give these personal views—is that stricter position limits would have been a good idea long ago and would be a good idea in the future.

Further, the low margins that exist in the commodities markets have, in general, increased speculation more than necessary. There ought to be some margin control to keep speculation in check.

At this particular time, there was an argument for reducing margins because the margins were very, very high at Comex at that time. But I think the higher margins had a salutary effect. It was the wrong time for them to change their minds on that.

But that is a preliminary view.

Mr. **Rosenthal.** You have said that is your own personal view. Could the Commission have moved these two exchanges into more positive action early on?

Mr. **Stone.** Our ability to influence the exchanges to use their powers as opposed to ours—and theirs are retroactive position limits and margins—is only by jawboning.

We have no authority to tell them to do that.

Mr. **Rosenthal.** I am trying to understand how much power of persuasion you have with these two exchanges, if any.

Mr. **Stone.** That is an important and good question. The answer is some, and perhaps not as much as there should be.

When we do not have statutory authority to insist that margins go up when necessary, it is very hard for us to jawbone an exchange into raising margins.

That deals with the last part of question 6.

Question 7 deals with the impact of excessive speculation on futures markets in general.

This is an area in which Commission, staff, and scholars who follow the commodities industry are very divided. You would find, I think, the preponderance of opinion saying that there is not excessive speculation, but rather that the level of speculation that exists in futures markets is necessary to allow commercial activity.

I am not in the majority on that view. That is not my view.

Mr. **Rosenthal.** That is the majority view on the Commission, the country, or among scholars, or where?

Mr. **Stone.** I am taking all those voices collectively, but I think it might be true in each area separately as well.

Mr. **Rosenthal.** Considering the events of last week, do you think there is much validity to the view that we ought to have more speculation?

Mr. **Stone.** As I said, that has never been my personal view. The events of the last week confirm my own view in my own mind.

Mr. **Deckard.** If the chairman will permit me, Mr. Stone, this is not the first time that one family, allied with a small group of other investors, have disrupted American markets.

In 1977 it involved soybeans and sugar and perhaps March wheat in 1979. Over the weekend one investor, ostensibly allied with this family, was quoted as saying that the market drop "played into our hands."

Can you explain how it would come about that the drop to $10 would play into their hands?

Mr. **Stone.** I heard that quote and I was puzzled about it. I remember that quote. It was attributed to unnamed Arab sources. I have no idea who those unnamed Arab sources are or what they meant.

The only thing I could surmise is that somebody is saying that if the price of silver fell low enough, they would try to acquire it all.

Mr. **Deckard.** I understand the same family owns about 450,000 shares in the Bache firm.

Could this constitute a conflict of interest or be detrimental to a firm or its customers where a majority stockholder conducts business of this magnitude through his own firm?

Should there be regulations or limitations on this kind of relationship, such as this family has with this firm, to guarantee an arm's-length relationship?

Mr. **Stone.** That might be a better question for Chairman Williams than for me, but from my point of view, I think that there is a conflict-of-interest question when a very large customer of a firm is also a borrower from the firm and a large shareholder in that firm, particularly if you are expecting the firm to play a substantial role in self-regulatory work.

The firms set their own margins here. Margin authority is divided between the firms and the exchanges. To that extent, if a substantial customer is a large shareholder of a firm, there clearly, in my view, is potential for conflict of interest and interference with good regulation.

Mr. **Deckard.** Why did you turn down Bache's request to suspend trading last week when there was an attempt to suspend trading during the liquidation of the March 1979 wheat contract in Chicago?

What were the differences between the two situations?

Mr. **Stone.** Those are very different situations. The difference is very important in explaining my philosophical approach to what our mission is.

I feel very strongly that it is the job of the Commodity Futures Trading Commission to protect small customers and to protect commercial users of the markets. It is not our job to protect very large speculators or the firms that seek their business.

That is the difference in those two situations. We were afraid that commercial users and hedgers would be hurt in that March wheat situation. In this case, it was large speculators and the firms that sought their business that were asking for the emergency action.

But I would like to add, if I may skip ahead—because you have asked me this question—to question 11, that the quote attributed to me in question 11 is not mine. I do not know where it came from. But it is not my quote. I did not say it. It is not my view.

I have just stated my view, however, on the same matter.

I would like to go back now to question 8.

It asked: What investigations or studies has the CFTC initiated?

We are conducting and have voted an investigation of the events in the silver market that you are now investigating. That could lead to any number of possible actions under the Commodity Exchange Act.

There are disciplinary actions that could conceivably bar an individual or firm from participating in the market. Or it could result in any number of punitive sanctions.

That has just recently been voted by the Commission and will be carried out vigorously.

Mr. **Rosenthal**. What was the vote?

Mr. **Stone**. The vote was unanimous.

The next question is whether we possess adequate authority and resources to prevent excessive speculation in the futures markets.

Here I must again preface my remarks by saying that I am not speaking for the full Commission. I know there is disagreement on this subject within the Commission.

My view is that question has to be answered with a distinct no. We do not have adequate authority to prevent excessive speculation. I do not find resources the biggest part of the problem, but authority.

In my view, if we are going to be concerned about the kind of situation we saw here, one that principally involves cash market hoarding, then someone needs to be given authority to set limits in cash markets.

That would be a major philosophical statement on the part of Government that someone should not own all the Picassos or all the silver. But that statement has not been made now. I have my doubts about whether it should be made. But I feel at least that the futures markets should not present a low downpayment way of acquiring huge physical positions because of their low margins.

Mr. **Rosenthal**. There is a distinction between whether someone could acquire all the Picassos as compared to silver or soybeans that are regulated. The public assumes that somebody is watching an even distribution and ownership of that commodity.

In other words, if we had a Picasso regulatory commission or an art painting regulatory commission, people would assume there could be no cornering of the market.

Mr. **Stone**. Yes, and that gets to a fundamental philosophical question that our authorizing committees dealt with when we were formed: whether we were to be the commodity trading commission or the commodity ownership commission or the Commodity Futures Trading Commission.

They specifically decided that we should be the Commodity Futures Trading Commission.

Mr. ROSENTHAL. In your own annual report you say that one of the regulatory objectives of the CFTC is to "prevent commodity price manipulation and market corners, curb unwarranted price changes caused by excessive large trade speculation."

In other words, you have acknowledged that you have responsibility in this area.

Mr. STONE. I am saying that, if anyone has the responsibility, the CFTC comes closest. But no one has the tools.

Mr. ROSENTHAL. All right. Go Ahead.

Mr. STONE. One of the tools——

Mr. ROSENTHAL. You do not have adequate regulatory tools, in your opinion.

Mr. STONE. Yes. In my view we do not have sufficient regulatory tools.

Mr. ROSENTHAL. Specifically what statutory changes would you personally like to see enacted?

Mr. STONE. I can only give you a preliminary answer here, but I will give you my feeling at this moment. This is subject to very careful evaluation of the implications of all these things; these are difficult questions. They have implications that affect other agencies, the Treasury and others, but in my view there ought to be very serious consideration given to Government having authority over commodities margins so that commodity futures markets are not used as a low downpayment acquisition vehicle for massive amounts of a physical commodity.

In addition, although we have some position limit authority, it is extremely awkward to use. It is awkward to use because it cannot be retroactive. Often these actions need to be taken very quickly. Action now requires due notice and hearing, which can be dragged on for many, many weeks, during which time additional positions may be taken. Our ability to act is frustrated also by the degree to which we are unable to aggregate the many accounts that someone can have if he wishes to disguise his large positions. It is further frustrated by the fact that we do not have a good ability to get behind foreign trading names to the real beneficial owner.

Mr. ROSENTHAL. In a word you are not able to do the job that you, yourself, acknowledge is your responsibility?

I am not blaming you. I think that is a fair assumption.

Mr. STONE. If it is to be interpreted that our job is to prevent the kind of thing that occurred in silver in the last few weeks, we do not have adequate tools.

Again, that is my personal view.

Mr. ROSENTHAL. I understand that. We will deal with that.

Mr. STONE. The next question is, What new regulatory authorities the CFTC favors to prevent a recurrence of last week's silver collapse?

I think I have given you my view. The CFTC has not taken a view as a commission on what powers it might ask for in the future.

We have already discussed margin requirements and position limits.

Question 11 gets into the quote, which is not mine. I am curious as to where you got that.

Mr. ROSENTHAL. It was from one of the major newspapers in this country.

Mr. STONE. I read them pretty carefully. I am surprised.

In any case, I did not say that.

Mr. ROSENTHAL. Do you want us to show it to you?

Mr. STONE. Whether or not someone quoted it, those are not my words.

However, what I did say——

Mr. ROSENTHAL. It was in the Washington Post, Saturday, March 29.

Mr. STONE. What I did say is that it is not our principal job to protect large speculators and the firms that seek their business. Our job is to protect small customers and commercial users.

It may have been embroidered into something more than was said.

Mr. ROSENTHAL. Please go on.

Mr. STONE. Question 12 is about previous problems in the silver market and earlier allegations about disruptions in the silver market.

The question is whether those past events should have alerted the CFTC to more prompt action.

I think the CFTC was alerted and those events contributed to the alert. The question was what to do.

Mr. ROSENTHAL. Over how long a period of time were you mulling over what to do?

Mr. STONE. I do not think it was a question of mulling over what to do. The problems were as I stated before.

The tool that would have been most useful, if we were afraid of a cash market hoarding situation, would be to raise margins. That would have been the most useful tool.

Mr. ROSENTHAL. Did you have authority to do that?

Mr. STONE. We had no authority whatsoever to do that.

Mr. ROSENTHAL. You could do nothing?

Mr. STONE. We could do very little. There is one thing that could have been done, but it would have had to be done before all of this occurred.

Mr. ROSENTHAL. What is that?

Mr. STONE. Back in 1977, the Commission voted not to have position limits. Had position limits, in fact, been voted, those would have been of some help.

But I do not think they would have averted this situation.

Mr. ROSENTHAL. Did you in any way anticipate the severity of the impact this silver collapse had or could have had on American financial markets?

In other words, in a couple of newspapers, other people were quoted as saying: "We were on the brink of disaster." That is a very serious thing.

Did you or any of your other Commissioners, if you could speak for your perception of their attitudes, have any feeling that what you were doing could bring this country down financially?

Mr. **Stone**. First of all, it was not what we were doing that caused the problem. Second, I think it is important to note that the fears that were expressed in the newspapers recently—valid fears of something of a chain reaction or a panic psychology in the marketplace—are very, very hard to test factually.

You are talking about a psychological reaction. The danger would have arisen if panic had spread to other markets.

Mr. **Rosenthal**. I understand that.

How would you characterize during the 6 months prior to last week the attitude of your fellow Commissioners and yourself toward the potential problems that were in the future and you could never really see specifically?

Mr. **Stone**. I used the phrase "deep concern" on numerous occasions.

Mr. **Rosenthal**. Good. I am glad you used that phrase. Some people would say maybe you were lackadaisical.

Mr. **Stone**. That would be wrong.

Mr. **Rosenthal**. Let me tell you what the facts are as I understand them.

As of today, as we understand it—and this is from a compilation of material that we have gathered in the last 2 or 3 days on silver—the Hunts control an estimated 150 million to 200 million ounces of silver.

The total domestic consumption of silver in the United States in 1979 was 166 million ounces. All of this began in 1973 when the Hunts bought 35 million ounces of silver and the price doubled.

In the spring of 1977, as Mr. Deckard indicated, the Hunts tried to corner the futures markets in soybeans.

One could draw certain implications about the modus operandi of these principals.

At that time the Commodity Futures Trading Commission accused them of violating limits on the number of soybean futures that can be held.

The Hunts argued they were acting independently, but the court ruled in early 1977 that various holdings controlled jointly should be treated in aggregate.

The class action against them by the shorts, sellers of soybeans, was dismissed for lack of standing.

In July 1979, the Hunts were sued by the Illinois attorney general on behalf of 3,500 State residents who alleged they were swindled out of $20 million in a land deal by the Hunts.

On October 18, 1979, the Chicago Board of Trade closed for 2 hours to discuss the "rumor" that there has been a cornering of the silver market.

The CBOT and Comex say there is no evidence that the markets are being manipulated and take no action.

On October 24, 1979, CBOT established a position limit of 600 contracts and Comex raises the margin to $50,000 a contract.

By this time the price of silver has trebled to $17.75 an ounce. The two actions were taken after officials of the exchanges and the CFTC discovered that a small group of speculators controlled nearly 75 percent of the more than 250,000 outstanding silver futures contracts.

The $50,000 margin is not exactly an impediment to the Hunts anyhow, since by this time their known silver holdings are estimated to be worth $6 billion.

On December 28, 1979, the Hunts, Nelson Bunker, and William Herbert, each purchased 3 percent of Bache and the brokerage firm loans the Hunts money to buy more silver futures and takes silver and securities as collateral. Trading in Bache stock was temporarily suspended by the SEC last Thursday when it appeared the company might go bankrupt.

The Hunts, as you know, refused to meet margin calls or come up with the extra collateral to replace the value of their fallen silver holdings, and Bache apparently was forced to liquidate millions of dollars of Hunts' assets.

This purchase of Bache stock, we understand, was consummated on the behest of Harry Jacobs, chairman and executive director of Bache, who feared a takeover. Presumably, the Hunts now own 5.6 percent of Bache.

We are going to play for you a tape recording of the Commission meeting that was held on July 27, 1979. We will give you and those others interested, the best transcription we can of this tape.

It is not really sensationally audible, but it does, I think, if we can achieve technical skills that we are not commonly equipped to deal with—it does achieve some understanding of the attitude of the Commission.

We will give out, as soon as the tape recording is concluded, the trancription.

If you have any corrections after your recollection is refreshed, please express yourself.

Mr. **Stone.** Mr. Chairman, before you begin, let me say that my general counsel has expressed some concern that that was a closed meeting. The tape contains the sort of information that is not permitted to be released under the statute.

Mr. **Rosenthal.** I appreciate the reservation of the general counsel.

This is a meeting of July 27, 1979. This tape was obtained by the subcommittee by virtue of a subpena served on the Commodity Futures Trading Commission. The Commission responded by delivery of this and other tapes which we were interested in because of another investigation, the live cattle contract traded on the Chicago Mercantile Exchange.

I do not know if this is going to work.

[Tape recording played.]

Mr. **Rosenthal.** Without objection, the transcript of this tape recording will be inserted in the record at this point.

[Transcript of tape recording follows:]

VERBATIM TRANSCRIPT OF PORTION OF JULY 27, 1979, COMMODITY FUTURES TRADING COMMISSION MEETING RELATING TO THE HUNT FAMILY'S SILVER FUTURES TRADING

GARTNER: Can I ask one general question?

-------: Yes.

GARTNER: The Hunts. Every week we see them in something, silver, soybean oil, livestock, whatever. Do you think there's any possibility these guys are just having fun, just horsing around. Like playing monopoly like you and I might do, or nickel and dime poker [laughter]. Is this a little game they're going through?

As often as not they're on the wrong side of the market and [unintelligible] the pattern of it is they just don't have much to do with their money [laughter], they're just playing around [laughter]

MIELKE: Well, they're playing around with some awfully big bucks.

I was looking at their silver position and on Chicago and New York combined -- and I'm talking basically about two brothers, Bunker and Herbert, their position is roughly 20,000 contracts long and 10,000 contracts short.

The net of that position, 10,000 contracts at $9.50 silver is worth $475 million dollars.

GARTNER: That's a lot of money.

MIELKE: That's a lot of money.

------: ...even by their standards.

DUNN: ...for you maybe [laughter]

-----: Certainly it is!

MIELKE: Herbert Hunt has limit positions in meal, oil and beans. Bunker has got 1,200 contracts long in October cotton.

STONE: Following Commissioner Gartner's curiosity, do we have any idea whether on balance they make substantial profits from all this activity?

MIELKE: I'm sure they have in silver, the way the silver market has moved and that may be financing ventures in other markets.

They have been net long silver all along and they've built some positions and silver moved dramatically. Other than that I really don't know -- I don't think they made any money on that June cotton deal.

STONE: Are their positions in silver big enough to have moved the market?

MIELKE: No, I don't believe so and their...normally, their posture is they'll be long in nearby futures with some short spreads out in __________ and as delivery month approaches they'll roll it forward.

Right now they're in 1980 futures, they're not in 1979 which is further advanced than they normally are.

GARTNER: It just seems to me there are people with a hell of a lot of money and not a lot to do with their time, fiddling around like you and I might play a game of checkers [laughter].

DUNN: General feeling of the trade is that these are often actions for tax losses.

MIELKE: Could be, I don't know.

DUNN: I don't know.

-----: I don't have that, not that much monopoly money.

Mr. ROSENTHAL. The summation is—one can have various interpretations of that meeting.

Did you fellows really think they were playing monopoly? Did anyone think they were playing?

Mr. STONE. The quotes you have attributed to me are only two and they are both questions. Those, in fact, were my questions at that meeting. They came across clearly on the tape. There is no question that you have correctly transcribed them.

I do not know and cannot speak for what other people meant when they asked questions.

Mr. ROSENTHAL. I think that is a fair statement.

The only conclusion I can draw is that the Commission was sitting by while the Hunts were amassing this very significant position in silver, and on two or three occasions—and there is nothing wrong with laughter—finding it funny that these fellows were gaining this unique financial position in a commodity that as we see can be so enormously disruptive to the security markets.

Commissioner Mielke says in here——

Mr. STONE. Mr. Mielke is a staff member.

Mr. ROSENTHAL. They have been net long silver all along and they've built some positions and silver moved dramatically.

Yet the Commission never did anything until when?

Mr. STONE. At the time this tape was made, the price of silver was lower than it is today.

The substantial movements were after that.

Mr. ROSENTHAL. But the position was already enshrined. As Mr. Mielke said on the bottom: "Right now they're in 1980 futures, they are not in 1979 * * *."

Well, it started moving by August 31. On August 31 it was $10.48, on September 28, $16.68, October 27, $17.07, November 30, $18.77——

Mr. STONE. That is a month afterward.

Mr. ROSENTHAL. On January 3, $38.40; January 15, $41.30, January 22, $49.

Mr. STONE. That is a month after this meeting.

Mr. ROSENTHAL. I know that, but you had all the market information. Your staff person said they were long and the market is moving. They did not make their move until they were ready.

Mr. STONE. We had a substantial amount of information. It gradually accumulated over time.

Mr. ROSENTHAL. Let me conclude this.

When did the Commission first do anything or take any action of any kind regarding the silver market? Just tell us the date.

Mr. STONE. Some 4 or 5 years ago.

Mr. ROSENTHAL. I am talking since the summer of 1979.

Mr. STONE. This has been a continuing situation. The actions that have been taken since the recent price movements last fall were essentially exchange actions and not Commission actions.

Mr. ROSENTHAL. Did you take any action at all anywhere since the summer of 1979 at anytime until last week?

Mr. STONE. It depends on how you define action. If expressing our concern to the exchanges and telling them that we think self-regulation and self-regulatory action is appropriate——

Mr. **Rosenthal.** Are there any written communications to the exchanges between the summer of 1979 and last Thursday when Volcker got in touch with you?

Mr. **Stone.** Most of those communications occurred at the staff level by telephone. We could check our files to see whether there are any written communications.

Mr. **Rosenthal.** I am still not sure in my own mind—and I do not want to pursue it further.

Has the Commission, as a Commission, taken any action regarding silver between the summer of 1979—that is, the date of this meeting, July 27, 1979—and last week?

Mr. **Stone.** Numerous actions of communications: a hortatory sort and a jawboning sort. But because we do not have the tools that would have been appropriate under the circumstances, we could not use those tools.

Mr. **Rosenthal.** OK, go ahead.

Mr. **Stone.** Question 13 is whether there is adequate coordination and cooperation among the various Federal regulatory agencies, specifically the CFTC, the SEC, and the Fed.

On an informal basis there is good cooperation. In my view, a case could be made for some sort of formal coordination and cooperation, which is the next part of the question.

But it would depend on the exact structure of that as to whether it would be more helpful than the informal communication we have now.

Mr. **Rosenthal.** There is no coordinating committee like there are in hundreds of other related issues in the Federal Government?

Mr. **Stone.** There is not one that includes the Chairman and that is why Chairman Volcker presumably felt that this informal coordinating committee that emerged last week was an appropriate way to handle that.

Mr. **Rosenthal.** Chairman Volcker acted in an emergency situation. Is that a fair assessment?

Mr. **Stone.** Yes.

Mr. **Rosenthal.** And you had never met him before. Of the other principals at the meeting, had you ever met any of them before?

Mr. **Stone.** Yes, I had met Deputy Secretary Carswell.

Mr. **Rosenthal.** How many times had you met Mr. Carswell?

Mr. **Stone.** I had not met with him to talk with him often. But I had met other people in the Treasury that we work with.

Mr. **Rosenthal.** Have you ever met Secretary Miller of the Treasury?

Mr. **Stone.** Yes, I have.

Mr. **Rosenthal.** In a business meeting?

Mr. **Stone.** Yes. My first business meeting with him as Secretary of the Treasury was last week.

Mr. **Rosenthal.** So last week you met for the first time the Secretary of the Treasury, the Chairman of the Federal Reserve Board; Mr. Williams you had met prior to last week?

Mr. **Stone.** Often.

Mr. **Rosenthal.** Many times. How many times?

Mr. **Stone.** I do not know. Maybe we can pool our resources on that.

How many times have we met or talked?

Mr. **Williams**. I am not sure. Quite a few times.

Mr. **Stone**. We talk often on the phone.

But most of the coordination between the agencies occurs at the staff level. So please do not——

Mr. **Rosenthal**. In May 1978 the General Accounting Office recommended the establishment of a statutory coordination committee.

What happened to that recommendation?

Mr. **Stone**. Congress did not enact it, but it did enact a requirement that there be close consultation between these agencies. There is consultation at a staff level.

Mr. **Rosenthal**. Your staff has met with Secretary Miller even though you, yourself——

Mr. **Stone**. My staff had met with Treasury staff, and with Federal Reserve staff. They talk with them often.

Mr. **Rosenthal**. OK, go ahead.

Mr. **Deckard**. Mr. Stone, over the weekend the Washington Post quoted you as acknowledging that your agency and commodity exchanges might have acted months ago to head off this trouble in silver.

What might you have done and why did you not take any action?

Mr. **Stone**. Yes, I did acknowledge that and I do acknowledge that I feel the appropriate thing would have been to use the weak tool we do have—position limits.

We are not able to say that we used every tool that was at our disposal. The tool would not have worked, in my judgment, to prevent this situation, but I still think that it should have been used.

The Commission voted in 1977 not to use that tool. I think it was the wrong decision.

Mr. **Deckard**. In an ideal world, at least as ideal as you view it in terms of your regulatory power, increasing the optimum level as you would view it, is there a possibility or a danger that transactions in these markets would move to the Bahamas or to Europe? Would that leave us even more vulnerable than we apparently are today?

Mr. **Stone**. That is an important question and one that would have to be addressed before some of these harsher tools, these stronger tools, that I have talked about were used.

To the extent that we do have, for example, a situation in which the problem is hoarding of the physical commodity, there is no reason why many of these physical commodities could not be acquired all over the world.

So, if we regulate tightly here, the same physical commodities could be bought in other parts of the world.

Mr. **Deckard**. I gather there was some relief last Friday when the price slide halted and the market firmed somewhat. This is obviously new buyers attracted by lower prices.

But do you have any knowledge of who these new buyers are? Are they traditional market participants, metal merchants, or industrial users?

Or, might they be foreign central banks conducting rescue operations? Are we witnessing the beginning of another speculative cycle such as we have experienced?

Mr. STONE. Some of the buying interest in recent days has been on the part of commercial firms who use silver. It is a source of some relief that users of silver are buying now.

But I cannot give you detailed or specific information on exactly who the buyers are.

Mr. ROSENTHAL. Please go on to question 14.

Mr. STONE. Yes.

The question is: How does inflation affect futures trading, including silver?

That is a question that is debated by economic theorists at some length. I do not think that anyone has arrived at a simple answer.

But certainly to the extent that inflation provides uncertainty in the market place, that is more reason to use futures markets.

In addition, there is some evidence that during a period of inflation people look to those things they feel will be protected from inflation. Precious metals have been among those.

It might be interesting to note, for example, that platinum—for which there is virtually no futures market at all—moved in price over a period of about 2 years from $200 to $950.

Mr. ROSENTHAL. The second part of question 14—does excessive speculation in silver and other futures affect the rate of inflation—what thoughts do you have on that?

Mr. STONE. There is not much evidence that speculation in futures markets, in general, contributes to the rate of inflation. In fact, some of the academic literature would indicate the opposite. To the extent that speculators loce money and commercials make money in futures markets, there may be some relief from inflation.

I do not know whether that is right. Therefore, it would only be a guess if I answered this question. I can tell you I do not know.

Mr. ROSENTHAL. How about question 15?

Mr. Williams is getting very edgy.

Have you called at least to find out what is happening with the markets today? Do you have a radio telephone in your hip pocket?

Mr. WILLIAMS. Not in my hip pocket, but I suspect I would be informed.

Mr. STONE. We know how the silver market opened.

Mr. ROSENTHAL. How did it open?

Mr. STONE. It opened approximately unchanged—just over $12.

Question 15 is whether the fall in silver prices affected futures prices in other commodities. You have listed some agricultural commodities.

The answer to that is probably in the short run, yes. In the long run, it is unlikely that it did.

Mr. ROSENTHAL. How about the Hunts' holdings of some of these other things, like soybeans?

Mr. STONE. In most of the agricultural commodities, there is not the kind of concentration that allows any user of the market at this point to have a great impact on price for more than a day or two.

Have hedging interests been hurt?

In general, the commercial users are those who gain from the lower price of silver. Many of them have been helped by the decline in the price of silver.

The next question is whether commodity brokers have suffered losses.

The answer to that is clearly "Yes." Some of them have suffered serious losses.

Mr. ROSENTHAL. Do you have any estimation at all as to what it amounts to in dollars?

Mr. STONE. I would be hesistant to give you a rough figure on that. This is the kind of place where we can make a sensitive situation worse if I gave you a wrong figure.

Mr. ROSENTHAL. If I guessed it would it make it worse?

Mr. STONE. I do not know.

Mr. ROSENTHAL. All right.

Mr. STONE. We will be able to give you an exact figure on that at some point in the future when the situation is less sensitive and when we have better numbers.

Will there be continuing volatility in commodities?

My guess is yes. There are many factors that cause these markets to be volatile. We have talked about some of them. They will continue to be volatile markets and will continue to raise some of the concerns that this event has highlighted.

What impact did the Federal Reserve's latest series of interest rate boosts have on speculation?

It can conceivably cut both ways, but to the extent that higher interest rates make it harder to finance long positions then it would be a factor that would operate in the downward direction.

I think that probably is the single greatest effect.

Has the relationship between high interest rates and commodity speculation been discussed with Chairman Volcker?

He and I spent a great deal of time talking in the last few days. Before that I had not. At the staff-to-staff level, I assume such discussions had gone on before. He and I have discussed that subject extensively in the last few days.

Can the CFTC regulate or even monitor trading activity in any commodity without information on foreign traders?

This is an important question. The answer is that foreign traders historically have had a very small percentage of the markets. So while it is a problem, it has not, until now, been a very serious problem.

What I fear, however, is that unless we can deal with that foreign trader problem, there is no use talking about better position limit regulation. If it can be escaped by dealing through foreign traders so that identities can never be found, it is going to be awfully hard to have effective regulation.

So I am more afraid of what not solving the problem would do in the future than I am of what it has done in the past.

Mr. ROSENTHAL. Have you conveyed those views to anybody in the administration?

Mr. STONE. We have talked with the State Department about the foreign trader situation. I have, on several occasions, talked with them. Commissioner Dunn and the staff have as well.

Mr. ROSENTHAL. Who did you talk with?

Mr. STONE. I talked with several people at the State Department. Assistant Secretary Katz was much involved before he left.

Mr. ROSENTHAL. He has been gone for some time.

Mr. **Stone.** Yes, I said before he left.

There have been others since then that have picked up his job. His successor, Assistant Secretary Hinton, just started a little while ago. He is now aware of that situation.

Mr. **Rosenthal.** Have you made representations to the British Government?

Mr. **Stone.** I had a visit to London which you asked about in the next question.

I was accompanied during all of my meetings by U.S. Embassy officials. Concern was certainly expressed on both the Embassy's part and our part.

We are in the process of considering new rules which would significantly tighten the data collection from foreign traders. We are also conducting an enforcement action that involves lack of reporting by a foreign trader.

Mr. **Rosenthal.** Are you always in the minority on Commission votes?

Mr. **Stone.** No.

Mr. **Rosenthal.** The impression you leave here today is that the majority of the Commission seems to be going down one road and you seem to be going down another road.

Do I misstate that?

Mr. **Stone.** There are certainly differences in philosophy. My philosophy tends to hold that where these markets affect the financial fabric of the United States, more regulation is needed. That is the case even if these markets do not in themselves pose substantial dangers.

Even if one were to look at the silver situation and say that the large speculators were hurt more than anybody else and, therefore, justice has been served, my view would be that there was danger to the financial fabric of the Nation and, therefore, we need more regulation.

I do not think that is the majority view of the Commission.

Mr. **Rosenthal.** Why do you think that is?

Mr. **Stone.** It would be difficult for me to speak for the others, but I am sure they would be available at some point if you wish to speak with them.

I hesitate to characterize anyone else's position. I can give you my own clearly.

It is important to understand that when our act and this Commission were first put together, people were talking principally about domestic agricultural commodities.

Since then there has been tremendous growth in financial commodities, in the metals, and in the worldwide implications of the agricultural commodities. It may well be that we are now in a situation where our tools are not adequate and where the regulatory structure was not perfectly designed for what we, in fact, now regulate.

Mr. **Rosenthal.** Of the items that you do regulate, do you have any notion of what the percentage is of agricultural and nonagricultural commodities?

Mr. **Stone.** Yes, I have figures on that I can supply for the record.

Mr. **Rosenthal.** Do you know it offhand?

Mr. **Stone.** It can be measured any number of different ways. The open interest, for example, in nonagricultural commodities is larger than the open interest in agricultural commodities.

The trading volume, on the other hand, is larger in agricultural commodites.

Mr. **Rosenthal.** The amount of money involved is larger in nonagricultural commodities?

Mr. **Stone.** Open interest would be one measure of the amount of money involved.

Mr. **Rosenthal.** Please go on to question 18.

Mr. **Stone.** Your last question is whether futures trading is moving out of the United States and whether the London markets have similar trading problems.

I would like to answer the second part of that first, about the London markets.

You have asked whether, without any of the limits imposed on trading here, they have similar trading problems.

They have extraordinarily active self-regulation to the point there are effectively position limits far tighter than any that we have considered here.

There is a small number of ring dealing members, for example, in the London Metals Exchange. They must act as principals. They are not going to stick their necks out beyond what their own capital can support.

Effectively the market itself imposes very strict position limits. What has happened here probably could not happen in the London futures markets.

I do not think the futures business will move to London, partly for that reason, and partly because I think the better regulated the markets are, the more likely they are to grow. More regulation will not hurt them, but will rather make them more honest. I do not, therefore, see business moving to London.

What I would fear is that cash market business can move anywhere on the globe, and quickly.

Mr. **Rosenthal.** Thank you very much.

We will go for a round of questions with my colleagues after Mr. Williams' testimony.

At this point I would like to have inserted in the record the percentage of agricultural and nonagricultural commodities.

Without objection, so ordered.

[The material follows:]

During fiscal year 1979, the breakdown of the open interest and volume was as follows:

	Percent
Open interest:	
Agriculture	40
Nonagriculture	60
Trading volume:	
Agriculture	58
Nonagriculture	42

Mr. **Rosenthal.** Mr. Williams, let me say I deeply regret that you had to sit here for all this period of time.

You perhaps got some value out of it.

STATEMENT OF HAROLD M. WILLIAMS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. WILLIAMS. Thank you, Mr. Chairman.

That is quite all right. I appreciate the tenor of the questioning on what is clearly a very important subject.

I do not have an opening statement, but if I may share several minutes worth of observations before I get into responding to specific questions, I would appreciate it.

I recognize and share the concern expressed by you and the committee regarding the events in the silver market last week and the related consequences.

As you are aware, the SEC does not regulate the markets of either silver or futures contracts in silver, nor does it regulate the activities of brokers and dealers in these markets.

However, a number of such commodities futures contract broker-dealers are also security broker-dealers registered with the SEC. Consequently, last week's activities in the silver markets as to which some of these brokerage firms faced substantial financial exposure, threatened to have a significant adverse effect on the securities industry.

Although there were some very serious moments during those events last week, in my judgment the securities industry has not been significantly impaired by the experience.

That is not to say there have not been some losses and that is not to say that further aftershocks will not occur.

But I have full confidence in the continuing viability of the industry even in these very difficult times.

The Commission, of course, is very concerned about last week's events in general, and particularly as they impact on the industry. Accordingly, we have initiated a two-pronged investigation.

First, the Commission is investigating whether there have been any violations of the Federal securities laws in connection with the events.

Additionally, we want to determine whether this experience suggests the need to enhance our regulatory controls, either administratively or, if required, by congressional action.

I should note to the committee that the existence of this investigation, coupled with the proximity of this hearing to last week's events, mandates some obvious constraints in my testimony—you have already indicated your sensitivity to that problem this morning.

Of paramount importance is that this hearing not impair the integrity of that ongoing investigation.

Within these parameters, let me begin to answer your questions.

Mr. ROSENTHAL. Before you do I have a couple of questions.

Can you characterize what happened last week in the kind of language we can all understand? Was it a potential disaster? Were we on the brink of disaster? Was there a potential crisis?

How would you characterize it?

Mr. WILLIAMS. Mr. Chairman, last week, so far as I am concerned, the first mission—my first concern and the first concern of the Commission, and I think of all of us—was to stop the bleeding and get the situation under control.

Mr. **Rosenthal.** Was it bleeding or was it hemorrhaging? [Laughter.]

Mr. **Williams.** That is hard to answer for several reasons.

One is that we spent a good part of the time last week making sure we understood what the facts were. That is No. 1.

No. 2——

Mr. **Rosenthal.** Just out of curiosity. What facts did you not know?

Mr. **Williams.** The positions and exposure of broker-dealers at that point in time—broker-dealers under the jurisdiction of the Securities and Exchange Commission; the position of commodity traders under the jurisdiction of CFTC. In other words, how broad and deep the tentacles of the Hunts went.

Mr. **Rosenthal.** What I do not understand is this. Why would you not know that in an ongoing fashion? I have been reading these newspaper stories over the weekend. One could take almost judicial notice of the activities of the Hunts, and their tentacles, and their Bache interest.

You obviously must have an up-to-date balance sheet of Bache and it shows the Hunts. I do not understand why you did not know all these pieces.

Mr. **Williams.** An up-to-date balance sheet of Bache, just to use that as an example, would not show anything that specific in relation to the Hunts.

Mr. **Rosenthal.** Bache has to reconcile their accounts at the end of every day. You get copies of all those reconciliations.

Mr. **Williams.** To begin with, but not in that kind of detail. We do not get them every day. But even when we get them, we do not receive them in that kind of detail.

Mr. **Rosenthal.** Your Commission is now going to go through an investigation to resurrect and rebuild the factual situation before you can fully comprehend it?

Mr. **Williams.** I would not go quite that far. We have been getting the facts as we move along. But, yes, I do not think any of us started from an up-to-the-moment actual base to assess where we were and what needed to be done.

I would say at this point—insofar as the areas that were under the jurisdiction of the SEC, the broker-dealer community—that I am satisfied that we know the facts. That is why I can make that statement.

Mr. **Rosenthal.** Do you know the facts as of today?

Mr. **Williams.** That is right.

Mr. **Rosenthal.** Have you been getting regular reports from the CFTC as to relevant information that might concern you in terms of the involvement of your broker-dealers?

Mr. **Williams.** I do not know what form that might take.

Mr. **Rosenthal.** Have they ever given you any information on anything?

Mr. **Williams.** Are you talking on a normal ongoing basis?

Mr. **Rosenthal.** On anything.

Mr. **Williams.** We have been in very close contact since last Wednesday, obviously.

Mr. **Rosenthal.** No, I mean before Wednesday.

Have they been giving you any information on a regular basis?

Mr. **Williams**. Not that I am aware of, no.

Mr. **Rosenthal**. That is terrible. Do you realize how terrible that is?

It is terrible or am I all wrong?

Here you have these Hunts and probably other little Hunts and big Hunts and things of that nature that have the ability to sink some of your broker-dealers, and send convulsive tremors into the financial markets of the United States and the world.

You never told him what was going on in the commodity markets, the Hunts concerning the silver market? Do you get the Wall Street Journal? [Laughter.]

Really, I cannot understand it. Perhaps I am stating it inappropriately. You have never given them any information? Why is that?

Mr. **Stone**. It would be contrary to our practice to give out position information unless specifically requested by another agency of Government.

Mr. **Rosenthal**. They never specifically requested it?

Mr. **Stone**. There is no ongoing communication of position information between the agencies. You are raising an important point.

Mr. **Rosenthal**. I get the message.

Mr. **Stone**. I do not mean to be arguing with you.

Mr. **Rosenthal**. It is very distressing to us, really.

Mr. **Stone**. I think that information should be exchanged on a regular basis.

Mr. **Rosenthal**. OK. Mr. Williams, I am sorry.

Mr. **Williams**. That is one of the issues that still has to be looked at. Hindsight is great. What we have to sort out is just whether and how and what kinds of information ought to be shared prospectively.

Certainly we have had our differences with the CFTC, but typically they have been in the areas where we both believe there is a jurisdictional overlap in terms of the financial product or instruments involved.

This is the first time we have run into a situation where I guess we would have to say that the activity within the product area had implications and impacts well beyond the purview of the agency that has primary jurisdiction. .

Mr. **Rosenthal**. Exactly. That is why Mr. Volcker called the meeting.

Mr. **Williams**. That is right.

Mr. **Rosenthal**. How would you described Mr. Volcker's demeanor when Mr. Stone walked into the meeting?

Mr. **Williams**. Mr. Stone walked in before I did. [Laughter.]

Mr. **Rosenthal**. So you missed that scene?

Mr. **Williams**. Yes, I missed that scene.

Mr. **Rosenthal**. Please proceed.

Mr. **Williams**. The first question is: How many brokerage firms are experiencing financial difficulty as a result of last week's collapse of the silver market?

I would use a different term than financial difficulty. There are seven firms involved that had some degree of exposure. In several instances there were losses.

But at this point, as I indicated in my opening comment, I think the situation is stable. We are not aware, at this point, of any——

Mr. Rosenthal. Could you in some way quantify that exposure or potential losses? Are these seven firms big firms, middle firms, or what?

Mr. Williams. They are all-size firms.

Mr. Rosenthal. What are their total assets?

Mr. Williams. I would have to get that for you.

Mr. Rosenthal. Thank you.

Without objection, so ordered.

[The material follows:]

Question. What was the exposure to registered broker-dealers as a result of the collapse in the silver market at the end of March 1980? What are the relative sizes of the firms involved, and what are their total assets?

Answer. As indicated in the oral testimony, seven securities broker-dealers were carrying accounts for the Hunts at the end of March 1980. The various accounts contained a range of silver and other commodity positions, including futures contracts, as well as securities holdings. At that time, total assets of the seven aggregated approximately $19 billion. A majority of the firms are among the largest in the securities industry, having over one billion dollars in total assets each.

As of March 31 when this hearing was held, the amount of potential losses publicly reported by the firms involved was about $64 million. All of the broker-dealers have indicated, however, that no losses were ultimately realized. The avoidance of actual loss has been attributed by them to one or more of the following factors: (1) liquidation of positions and collateral, or the subsequent hedging of futures contracts; (2) increases in the price of silver; (3) offsetting deficits with equity in other Hunt accounts at the same firm (cross-guarantees); and (4) additional cash payments by the Hunts to the firm. As the Subcommittee is aware, the Commission is engaged in an ongoing investigation of these events.

Mr. Rosenthal. Can you tell me in any more literate way whether these were—how many were big? Were any of the seven very big?

Mr. Williams. I think three have made public statements. Bache has indicated a rather significant problem which, as they reported last Friday night, they believe is well under control.

Paine Webber reported a loss of $10 million. A. G. Edwards of St. Louis reported a loss of some $4 million.

Mr. Rosenthal. Those are the large losses?

Mr. Williams. Yes, sir, they are. In fact, I do not believe there have been any other losses of any consequence today.

To the extent we are dealing with public firms, and we essentially, are, there are disclosure obligations under the Federal securities laws to disclose any material problems of that type.

What steps has the SEC taken to deal with the situation?

We operate in a two-tier regulatory mode. The broker-dealers involved are under New York Stock Exchange jurisdiction. The exchange is self-regulatory. The exchange has had its examiners in, and the Commission has also had its examiners in.

The extent to which we have been in and where we have been depends upon our judgment of the depth and seriousness of the problem.

I, personally, have been on the phone, and so has our staff, since Wednesday through this morning to make sure we are on top of it and we understand what, if any, continuing consequences there are. I am advised that Bache & Co. has issued a further release this morning. I have not seen the release, although I am quite sure I know generally its contents from discussions with them.

It will articulate more specifically the extent of the losses experienced by Bache.

Question 2 is: To what extent are major Wall Street brokerage houses involved in futures trading?

I cannot quantify it for you. They are involved. It varies by firm and by type of customer. It also varies between futures trading, including margins, on behalf of customers and, in some instances, on what I consider to be a modest amount of proprietary trading.

Mr. **Rosenthal.** So, because of that and because of your other concerns and interests, you are seriously and deeply concerned for the efficacy of the regulatory actions of the CFTC?

Mr. **Williams.** Yes, sir, we are.

Mr. **Rosenthal.** Are you going to tell us about some thoughts or ideas you have of how to make that more efficacious?

Mr. **Williams.** Would you like me to jump to question 4 now?

Mr. **Rosenthal.** No, go on to question 3.

Mr. **Williams.** Question 3 is: Does the SEC have any concerns over the mixing of stock and futures trading by brokerage firms? If so, what kind of regulatory changes might be indicated?

I would say we have more concern today than we did last Tuesday, significantly more.

This is one of the areas that we will be looking at very hard. Obviously there are differences in exposure and risks. It is premature to be diagnostic, let alone prescriptive.

But I would say that early areas to look at would be a more definitive segregation of commodity activity from other, more traditional broker dealer activity.

Possible there should be some form of customer limits imposed through our vehicles, and possibly some net capital rule changes that would place greater restraints on certain types of activities, particularly if they exceed a certain level.

We need to understand what the consequences of each of these approaches would be to be sure that we would be achieving with them what we intend to achieve and not something we did not expect that would cause some other problems.

Is the Commission satisfied with the effectiveness of the CFTC general supervision of the futures markets and its specific regulations of the silver market?

I cannot sort out, Mr. Chairman, and I am not prepared to this morning, the effectiveness of the supervision from any other constraints that might exist, statutorily or otherwise, in terms of how the CFTC functions.

When I look at the results and the implications for—as Chairman Stone characterized it—the financial institution fabric of the country, I am concerned.

Now to what extent this should be dealt with——

Mr. **Rosenthal.** We will have to do something about this. We have to either beef up the statutory authority or something about the character of the Commission. I understand there is a vacancy on the Commission today.

Something has to be done. Is that not correct?

Mr. **Williams.** I would think so.

I might suggest that, as I think Mr. Stone has indicated, greater authority on the part of either the CFTC or the Fed in the area of margins is needed, as well as the ability to impose position limits, and the ability to impose suitability requirements.

These are tools that we use in our markets. We find them to be quite effective, to varying degrees. There are ways around one or another. But with adequate oversight and adequate inspection and adequate penalties, you keep the evasion to a relative minimum. It is better to have them and have some evasion that not to have them at all.

One wonders whether it is a matter of regulatory philosophy, but there is a question of the extent to which one should limit oneself to emergency action and to what extent one should use a more restrictive prophylactic approach.

Whether that is a matter of philosophy or a matter of statute, I am not in the position to evaluate this morning.

The next question is: How serious is the SEC's recent criticism of the CFTC for permitting too rapid a growth in the trading of "exotic futures," such as Government bonds, home mortgages and other financial futures?

I do not recognize the criticism in that form.

We tend to move cautiously in terms of expansion.

Mr. **Rosenthal.** I am reading from the Washington Post of February 13, 1980, which says: "Three Federal agencies accused the Commodity Futures Trading Commission yesterday of allowing trading in exotic futures contracts to grow too fast * * *." This included your own agency.

That is what I was referring to. That is, the SEC, the Federal Reserve, and the Treasury all criticized the CFTC for allowing that.

Mr. **Williams.** We tend to move cautiously and to want to understand how these things function. We have been concerned about the rate of growth.

I do not know that we have made a judgment that that rate has been too rapid. I do not know if there are exotic futures. Certainly Government bonds are not exotic.

Certainly our concern, for example, in the options area has been to understand the extent to which these instruments serve a constructive purpose in terms of serving as a pricing mechanism or as a hedging vehicle.

What their role should be and what concern we should have to the extent to which they are utilized for speculative purposes, particularly in complex economic times, as we are in now, should be addressed.

There are issues, particularly, in some of these areas that do relate to overlapping jurisdiction that causes us even greater concern. In that sense, we have urged the CFTC to go slowly because we are concerned about things falling between the cracks, between our jurisdiction and our responsibility and the way they see theirs.

Mr. **Rosenthal.** All I know from reading this article is that the SEC General Counsel, Ralph Ferrara, says his agency believes the same regulations that apply to the sale of any stock should apply to the sale of any stock index futures.

Mr. **Williams.** That is right.

Mr. **Rosenthal.** And the SEC's disclosure regulations rule to protect investors are tougher than those in the CFTC.

Robert Carswell, Deputy Secretary of Treasury, urged Congress to consider whether CFTC's resources are adequate to regulate futures trading in Treasury bills and other governmental, that is, all the new financial instruments, as did Peter Caras, Assistant to the Federal Reserve Board.

Mr. **Levitas**. Mr. Chairman, the Chairman of the SEC made a statement which I did not quite understand. I wonder if he would expand on it.

You said you had some reservations about the role or the proper function being played by trading in certain of these options in our economy as opposed to being simply a means for speculation.

As I understand those words, what you are suggesting is that the possibility exists that some of the trading in options has no economic substance to it and simply is some sort of national lottery that is being conducted, or speculation gambling rather than something related to the economy itself, as presumably the stock exchange in agricultural commodity futures are concerned.

Is that what you are saying? Or is that the issue?

Mr. **Williams**. Let me answer it this way: Speculation and a national lottery are by no means synonymous. Speculation is a higher risk venture in which the economic purposes in itself is the speculation. For some people that is a valid economic purpose.

It differs from a lottery because it still involves, for people who know what they are doing, a very real element of judgment.

Mr. **Levitas**. But if it is the end in itself, the speculation is the end in itself, and these very wealthy people want to play games with each other, that is one thing.

But if the consequence of their actions has a tremendously devastating effect on the rest of the economy, is there not a public purpose being served?

Mr. **Williams**. There most certainly is.

Mr. **Levitas**. Is that not the question you are raising?

Mr. **Williams**. That is a good piece of it. You can slice that more finely. That is why I started off by saying that certainly there are terms of options which we know better than we know futures. We are working with them on an ongoing basis.

But we obviously are concerned about both.

I have, in my earlier life, been involved in commodity future hedging. It is very important, at least, for agricultural commodities. Others can speak with more authority than I can on metals as commodities.

Hedging is a very important price discovery mechanism. It is the way the price of the product is, in fact, established. In terms of securities options on securities, they serve a very legitimate hedging purpose, as they do in commodities as well.

To what extent one needs involvement by speculators to make those markets efficient is something that different people have different opinions on. I suspect you need some, but not necessarily as much as we have.

Certainly at one end of the spectrum things can get a little carried away, as they seemed to last week. At the same time, from the Commission's standpoint, we have taken a position on options that we have suitability requirements placed on the broker dealer before a customer of the broker dealer can engage in options trading.

We want to be sure that, as often happens with these situations, it is not the innocent person who does not understand the risk involved, but who hears these great stories about all the money that is being made—who gets sucked into the game.

Mr. ROSENTHAL. Please continue on with the questions. We are almost at the end.

Mr. WILLIAMS. Does the SEC concur?

Mr. ROSENTHAL. Mr. Stone diassociated himself. What do you think about the proposition enunicated here?

Mr. WILLIAMS. Mr. Chairman, I would have to answer you in several ways.

No. 1, I happen to believe that a company in this country ought to be able to go broke and be allowed to go broke so long as the national consequences of going broke are not too devastating. The question is where that line should be drawn.

Mr. ROSENTHAL. Such as Chrysler?

Mr. WILLIAMS. Do we want to get off on that one? [Laughter.]

What I am saying is that I might agree or might not agree on what we did with Chrysler, but Chrysler presented the issue.

Mr. ROSENTHAL. The question I really want to ask is this.

Should there be a Government policy in reaching that decision? Or should it be left to the CFTC?

That is the question.

Mr. WILLIAMS. That really gets to your question seven also.

I would say that we do not have the deliberative mechanism today to arrive at the answer to that question in the ultimate national interest.

Mr. ROSENTHAL. In other words, would you have felt offended if Mr. Stone's agency was going to let Bache and the other two or three that you mentioned go broke?

Would you have felt you had lost some of your turf in that regard?

Mr. WILLIAMS. If the damage to the securities industry, and indeed to the economy as a whole, could have been limited, or would have been limited to Bache, to my satisfaction, I would have said, "No, that is Bache's problem."

But in a skittish market with implications that were potentially much broader, I think the national interest question would be somewhat different.

Mr. ROSENTHAL. How would it be different?

Mr. WILLIAMS. I think you have to look at what we started off saying.

There was a challenge here to the financial fabric of the country. I think the issues have to be looked at in that context.

That does not necessarily mean that that suspension of trading in any context ought not to be done very, very sparingly. There ought to be a very strong burden of proof for suspension of trading.

Suspension of trading increases the constipation. There is no place for the market to function to get rid of the problem that is there. Someday you have to open trading again.

So, I am not sure there is a cause and effect relationship between suspension and nonsuspension and bankruptcy or nonbankruptcy. That is a separate issue.

Suspension may sound attractive because it sort of buries the problem for the moment. Nobody can trade. You cannot lose money. But you cannot solve the problem, either. Suspension can be used in the sense that it may prevent trading which would have been based on inadequate or inaccurate information.

Mr. **Rosenthal**. Well sometimes you can let off a lot of psychological steam during a suspension.

Mr. **Williams**. Very true.

Mr. **Rosenthal**. The only thing that worries me is whether you are concerned about what they are doing.

Mr. **Williams**. Sure we are.

Mr. **Rosenthal**. How are you going to show that concern?

Mr. **Williams**. We found a way to deal with it this past week. I think we dealt with it in an ad hoc fashion, but well.

Mr. **Rosenthal**. Without Mr. Volcker, how would you have done it? Where would you have met up with him?

Mr. **Williams**. It so happened that the Chairman made the first call. I have no doubt——

Mr. **Rosenthal**. Chairman Volcker?

Mr. **Williams**. Yes. I have no doubt that if he had not, one of us would have. We would have been together that afternoon one way or the other.

Mr. **Rosenthal**. What makes you say that?

Mr. **Williams**. I am confident of it.

Mr. **Rosenthal**. You were willing to let Bache go under. So you would not have made the call.

Mr. **Williams**. No, wait a minute. I did not say I was willing to let Bache go under.

Mr. **Rosenthal**. What were you willing to do?

Mr. **Williams**. I am not saying at all I am willing to let Bache go under. The question posed was whether I would be concerned about losing turf, and in effect, whether I felt by implication under those circumstances should Bache be allowed to go bankrupt or not.

So far as I am concerned, in principle whether it is a broker-dealer or any other kind of corporation——

Mr. **Rosenthal**. I think I mischaracterized the tenor of the question by talking about turf. I really did not mean it that way. I was just trying to find how sensitive you were to the issue.

We cannot let the CFTC bring this country down, not with their record. [Laughter.]

Mr. **Williams**. Again, Mr. Chairman, the country did not come down last week. We are going to learn something from this. We have to do better.

I am sure there are things we can all do that will improve upon that.

Mr. **Rosenthal**. It may not even be their fault. It may be the fault of the Congress for not giving them sufficient and adequate statutory tools.

Mr. **Williams**. I think that is the job that we face now in terms of sorting it out and coming back with some more constructive ideas of what we can do individually and what we need legislation for, and whether the coordination and cooperation is indeed adequate.

Mr. Ferrara's testimony that you referred to earlier described a number of areas in which our joint policy committee is working together.

There are other activities going on between the Fed and Treasury and ourselves and the CFTC at the staff level to address some other issues.

However, one coordinates efforts in what might be viewed as at least a potential emergency in circumstances where the broader national interest is involved, we had to deal with that ad hoc last week.

Mr. Chairman, I would say that we designed the system with regulatory agencies and otherwise, 50 years ago, or longer.

It is a very changing world. I think the issues presented here are largely credit issues, probably more than the other kind. But I do not know any form of regulation in the complex environment in which we are functioning today will, of itself, be totally adequate. We are going to have to be responsible and responsive and move ad hoc and move quickly in some situations.

Mr. **Rosenthal.** Mr. Deckard?

Mr. **Deckard.** Thank you, Mr. Chairman.

This is a question I earlier asked of Mr. Stone and I think more properly should have been addressed to you. It has to do with the Hunt family and their relationship with the Bache firm.

In your view, is it a conflict of interest for a major stockholder, such as the Hunts in the Bache firm, to conduct business in such a considerable magnitude through that firm?

Mr. **Williams.** I have to defer to answering that question. That is a matter that the Commission will be looking into.

Mr. **Deckard.** The possibility of additional regulations or some type of limitations on the volume of business conducted with the firm?

Mr. **Williams.** Both prospectively and to address that question specifically.

Mr. **Deckard.** Finally, I would have Mr. Stone respond as well.

In you opinion, who is best able to regulate financial futures, the CFTC or the SEC?

Mr. **Stone.** To regulate what?

Mr. **Deckard.** Financial futures.

Mr. **Stone.** Which of us should respond first?

Mr. **Deckard.** Mr. Williams? Or, if there is a contrary view, Mr. Stone?

Mr. **Williams.** This is an ongoing issue and in a sense, another day's question.

So far as financial futures are concerned, the position we have taken in the past is that futures related to underlying instruments should be regulated by the same agency that regulates the underlying instrument.

We are charged with the responsibility for regulating securities, traditional securities, equities, and debt securities that are publicly traded by private corporations.

And, to that extent, our view is that we should—and I can go into a lot of detail as to why—have the responsibility for the futures as well.

From the surveillance and the administrative standpoint, these are so intertwined that effective regulation and surveillance of the markets in relation to one calls for similar responsibility in relation to the other.

In terms of financial futures, it depends on what kind you are talking about. Most of those are not under our jurisdiction except in a fraud context—that is, fraud on the market.

I think you would have to obviously ask Treasury about this, but I know they have expressed some concern in relation to futures on governments in terms of what the regulatory scheme is there.

Our particular interest would relate to futures on securities or on indexes on securities.

Mr. **Deckard**. I am not interested in pursuing the question unless Mr. Stone would like to respond.

Mr. **Stone**. Not at this time.

Mr. **Rosenthal**. Mr. Levitas?

Mr. **Levitas**. Thank you, Mr. Chairman.

Mr. Stone and Mr. Williams, one of the things that disturbed me—and still does more than anything else—about what happened in the performance of CFTC and other agencies is that correctly or otherwise the American public perceives that by virtue of the existence of an organization called the Commodity Futures Trading Commission, that there is some built-in protection for them which they can rely upon.

They place, in my judgment, more confidence than they should in the existence of the Commission itself. I have the same feeling about the SEC.

How many people pay any attention to the disclaimer on the front of the prospectus that you pass no judgment upon the merits and so forth?

What do you think the CFTC can do to either get the story straight to the American people that these types of things will happen whether or not the CFTC exists or to assure the public that this cannot happen? What do you think can be done?

Mr. **Stone**. I think you have raised an important point.

The Congress decided to regulate the futures industry primarily by self-regulation within the futures industry and to create a small agency with limited powers that has oversight responsibility for that self-regulation.

Some people who buy and sell futures or are urged to buy and sell futures undoubtedly misunderstand the weakness of the CFTC in that respect.

I think it is incumbent upon us to stress in our communication with the public, including written literature, cautionary facts.

I think there has been too much of a tendency in the past for the CFTC to talk about how secure the markets are, whereas in fact, I think our emphasis should be on the cautionary side and let those who are in the business work on the other side.

Mr. **Levitas**. I commend you on that statement. I think Congress has traditionally created the situation in which that atmosphere exists. The problem arises when Congress creates an agency with some very significant sounding title. The public believes that is the solution to the problem when, in fact, it is not a solution to the problem.

Indeed, it creates the potential of even greater problems because the public thinks it is the solution to the problem.

They stop remembering caveat emptor and rely exclusively on an agency which was not given the powers to do what the public perception and the congressionally created perception of it was to do.

Do you not think there should be as much concern demonstrated when the prices of commodities are rising in an unusual manner as demonstrated when prices of commodities begin to drop in an unusual manner?

In other words, when you see the water being sucked out from the beach is the time to worry about the tidal wave, not when it is crashing over the beach on the way back.

Mr. STONE. Absolutely, yes, at least as much concern.

Mr. LEVITAS. But that is not the case because everybody seems to be making money when the market is going up or when the futures trading are raising prices.

What can the regulators do about that both in the securities market and in the commodities market?

Mr. STONE. Our regulatory scheme is largely designed to function through emergency powers rather than precautionary powers.

I think that may not be sufficient and tends to have us act in a crisis mode where we have quite broad authority. But I think if we are concerned about the futures industry jeopardizing the financial fabric of other institutions, those precautionary powers may be even more important than the emergency powers.

Mr. LEVITAS. Mr. Williams, do you have any comment on that?

Mr. WILLIAMS. Within our areas of responsibility, the self-regulatory organizations, and, to the extent it has the resources, the Commission as well, will track market movements both ways on individual securities.

When they exceed what appear to be normal parameters for that type of security, questions are raised in determining why and what happened.

Mr. LEVITAS. In fact, frequently, trading is suspended when prices of securities are rising in an unusual heavy market beyond those parameters?

Mr. WILLIAMS. Beyond where we can get a ready explanation.

Mr. LEVITAS. I am suggesting the same thing needs to be done in the case of commodities futures and maybe Congress should do something about that.

Mr. Williams, banks are subject to very strict regulatory requirements as to how much they can lend to any one customer, based upon their capital structure, so that the default of any one customer will not jeopardize the entire bank.

Are brokerage firms subjected to the same type of limitations?

Mr. WILLIAMS. No, sir, they are not.

Mr. LEVITAS. Should they not be?

Mr. WILLIAMS. Broker-dealer loans are secured. At least there are margin requirements. But that is a question that obviously we are going to have to take a look at.

Mr. **Levitas**. Does the SEC plan to take a look at that particular issue?

Mr. **Williams**. Certainly.

Mr. **Levitas**. Now if Bache & Co., had not recovered any money on its loans to the Hunt brothers, I gather they would have gone out of business.

Mr. **Williams**. I am limited as to how much I can say in this area. But it really was not ordinary loans. They were margin purchases.

Mr. **Levitas**. That means less than the amount of the purchase was paid for by the purchaser and, therefore, the differential——

Mr. **Williams**. They were able to liquidate their way out of the problem.

Mr. **Levitas**. But if they had not, and given the size of the margin account, is it not fair to say that Bache would have gone out of business?

According to the news reports it seems that way to me.

I do not have to be a financial analyst to know what I read in the newspaper.

Mr. **Williams**. Yes.

Mr. **Levitas**. They would have gone out of business.

In that case, do you know at this time what the losses would have been to the Securities Investors Protection Corporation reserve fund?

Mr. **Williams**. No, sir, I have no way of knowing.

Mr. **Levitas**. Will a determination be made as to that potential exposure so that we can have some sense as to whether this umbrella, if needed to be called upon, would have been there?

In other words, I am suggesting that we ought to have that information.

Mr. **Williams**. Frankly, one would have to talk with the people at SIPC to know whether they would have a basis for computing it at this point.

Mr. **Levitas**. I think you ought to know that, too. If they do not, then there should be.

Mr. **Williams**. They are the undertakers. They go in and count it all up when everything is over. And whether they would have a way of doing it now without—or whether we could play an effective "what if" game, I do not know.

Mr. **Levitas**. Are they not in a position to make some reasonable prospective judgment as to their potential contingent liability in certain circumstances?

Mr. **Williams**. I would think so. I honestly do not know. We will find out.

Mr. **Levitas**. If not, they should be.

Other than losses to the Securities Investors Protection Corporation, what other impacts do you think would have occurred in the financial markets in the event of Bache's collapse?

Mr. **Williams**. That is hard to speculate about.

Mr. **Levitas**. In the retrospective analysis study to be made by the Securities and Exchange Commission, do you think that type of doomsday retrospective should be made?

In other words, to state if this had happened and that had happened, what else would have happened so that maybe we can find ways of avoiding those subsequent consequences.

Mr. WILLIAMS. We will see what we can do with that.

It is difficult, at best and as I also indicated earlier, the large part of what happens depends upon how insecure people get. I think, for example, that Friday might have been somewhat different than it was if the market had not recovered as well as it did Thursday afternoon.

Mr. LEVITAS. I am certain the SEC when it begins to look at this will raise that same question.

I would suggest, Mr. Chairman, that we request the SEC to furnish the committee with whatever analysis they make of that scenario.

Mr. ROSENTHAL. I announced before you arrived that these hearings will continue on April 14 and April 15 and between now and then, or at least as of then, you will provide the information.

Mr. WILLIAMS. I think we will have much more by then.

Mr. LEVITAS. I thank you.

Mr. ROSENTHAL. Mr. Atkinson?

Mr. ATKINSON. I have one question following Mr. Levitas.

I apologize for coming late. I do not know if this question has been answered yet.

Everybody wants to eliminate regulations and be self-regulated. Things like this happen and it involves the Congress as to what will come out of it.

I am wondering if the SEC would support the extension of similar Federal Reserve requirements for commodity futures—should it be required for brokerage firms as they exist now?

Mr. WILLIAMS. Whether the Fed should have authority to impose margin requirements? Yes, sir, we would.

Mr. ATKINSON. You do support that?

Mr. WILLIAMS. Yes, sir.

Mr. ATKINSON. That is the only question I have.

Mr. ROSENTHAL. Thank you both very, very much. I hope we did not disrupt the markets or disrupt your weekend or cause too much pain and suffering.

But we thought this was a very serious event.

We will continue on April 14 and April 15. We will send you, in adequate time so that you can prepare, a further list of inquiries.

The subcommittee will stand in recess until that point.

[Whereupon, at 12 noon, the subcommittee adjourned, to reconvene subject to the call of the Chair.]

SILVER PRICES AND THE ADEQUACY OF FEDERAL ACTIONS IN THE MARKETPLACE, 1979-80

MONDAY, APRIL 14, 1980

House of Representatives,
Commerce, Consumer,
and Monetary Affairs Subcommittee
of the Committee on Government Operations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2247, Rayburn House Office Building, Hon. Benjamin S. Rosenthal (chairman of the subcommittee) presiding.

Present: Representatives Benjamin S. Rosenthal and Joel Deckard.

Also present: Barbara Timmer, counsel; Doris Faye Ballard, clerk; and Jack Shaw, minority professional staff, Committee on Government Operations.

Mr. Rosenthal. The subcommittee will be in order.

At today's hearing on the Federal response to the collapse of the silver market and the impact of that event on the securities industry and markets, the Commerce, Consumer, and Monetary Affairs Subcommittee will receive an update on the publicly held companies, securities and brokerage firms most affected by March silver trading.

The subcommittee has also asked Chairman Williams to suggest both conceptual and specific changes in the present regulatory relationships affecting those markets, particularly the role the SEC should exercise over derivative markets, including proposed futures contracts based on securities.

We are very pleased that Chairman Williams could be with us this morning. We are ready to hear from you.

STATEMENT OF HAROLD M. WILLIAMS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION—Resumed

Mr. Williams. Thank you, Mr. Chairman.

In response to your request, I am pleased to return today to discuss recent events in the silver market, their impact upon the Nation's capital markets and upon the securities industry, and the implications for regulatory or legislative measures which might be taken to prevent or reduce the likelihood of a recurrence of these or similar market disruptions.

While the Commission and other Federal agencies are still engaged in learning all the facts surrounding the precipitous decline in silver prices in March, this episode has already served to underscore the exceedingly sensitive character of this country's organized securities markets and futures markets and the close interrelationship of those markets.

In its invitation to appear today, the subcommittee requested that I address three specific areas, to which I now turn.

The subcommittee first asked for a status report on the publicly held companies, securities and broker-dealer firms most affected by March silver trading, and the aftershocks, if any, which may be expected in the days and weeks ahead.

With regard to the brokerage firms, the staff of the Commission has been in contact with those major firms known to have held substantial positions in silver futures, particularly those firms having significant dealings with the Hunts.

On the basis of the information provided, we have reasonable assurance that no such firm is presently in financial difficulty as a result of its dealings in silver or silver futures. With regard to the status of publicly held companies and the markets for their securities, I am sure the subcommittee is aware of the publicity that has surrounded two public companies in particular, Bache Group and Englehard Mining, both of which were involved in substantial silver dealings with the Hunts and experienced temporary halts in the trading of their stocks.

Since the silver market break on March 26–27, Bache has publicly disclosed receiving approximately $40 million in cash payments from the Hunts on their silver account deficits and has confirmed the Hunts' intention to pay any further amounts due to cover their silver trading losses.

The Commission further understands that Englehard, a major metals trading company, has reached settlement with the Hunts as to certain recently matured silver contract obligations, reportedly on favorable terms. Thus it appears to the Commission that both companies have emerged from the March silver trading and their Hunt dealings without a continuing threat to their financial viability. As for other public companies, while of course those with heavy silver involvement, particularly small silver mining companies, have seen the market price for their stock erode substantially in the past several months, we are aware of no major public company that is now in jeopardy as a result of its dealings with silver or silver futures.

What the longer term impact on the financial markets will be from this experience is more difficult to assess, as I am sure you are aware. We do believe that the protective actions taken by brokerage firms in the midst of the silver crisis have substantially reduced the exposure of the brokerage community to further volatility in silver prices, particularly in Hunt accounts.

For that reason, we do not anticipate that the securities markets will likely experience any more severe aftershocks caused directly by the recent upheaval in the silver markets.

The Commission's concern over the events of the past month, of course, has not abated simply because the immediate threat to the securities markets from the silver problem appears to have passed. The Commission has commenced an inquiry into the circumstances surrounding what has transpired. While it is premature to comment on what findings that inquiry may turn up, the subcommittee should be aware that we are coordinating with the CFTC and other interested Federal agencies to assure that inquiry proceeds expeditiously without unnecessary duplication of regulatory effort.

In addition, the Commission is actively considering whether changes in its financial responsibility rules, particularly in the net capital area, should be made to protect the securities activities of broker-dealers from undue exposure to commodity trading risks. I wish to assure the subcommittee that we are pursuing our existing regulatory alternatives vigorously.

The subcommittee also asked for our comments on proposed amendments to the Commodity Exchange Act proposed in May 1978 by the General Accounting Office.

At the outset, I would like to point out that the CFTC and the Commission have undertaken in good faith to consult with each other on matters of mutual regulatory concern, both before and after Congress mandated consultation between the two agencies in the Futures Trading Act of 1978.

However, our experience over the last 2 years indicates the shortcomings inherent in a legislative scheme which bifurcates regulatory responsibility with respect to underlying securities and derivative instruments based on those securities, and then attempts to bridge the information gap created by that bifurcation through a requirement of interagency consultation.

Mr. ROSENTHAL. What does bifurcation mean?

Mr. WILLIAMS. Divide up.

Mr. ROSENTHAL. But that is a much more interesting way to describe it, isn't it?

Mr. WILLIAMS. Bifurcation is an unnatural condition in my opinion.

While refinements can, of course, be made to the mechanics of interagency consultation, the Commission believes the sounder, more efficient legislative approach is one which provides, to the greatest extent practicable, for vertical integration of regulatory responsibility.

Under this approach, the agency with authority to regulate the cash or "spot" market in a commodity or security should also have regulatory responsibility over all instruments which create a right or obligation later to acquire or sell that commodity or security.

I would add that it is not only a matter of logic, but a matter of effective discharge of regulatory responsibility that authority over cash and futures trading be within the same regulatory agency.

The three amendments to the Commodity Exchange Act proposed by the GAO in 1978 offer a possible way to provide for the vertical integration of regulatory responsibility. The first amendment would exclude from the Commodity Exchange Act's definition of a "commodity," securities which are subject to the registration provisions of the Securities Act of 1933 and any index composed of such security or an aggregate of such securities.

By doing so, the amendment would refocus responsibility over futures on stocks, stock indexes, and corporate debt instruments in a manner which I believe would provide for a more effective regulatory scheme. An alternative way to achieve this result would be to use the criterion of registration for the trading of securities under the Securities Exchange Act of 1934 as a reference, instead of the 1933 act's definition, thereby providing perhaps greater certainty over the types of securities to be covered.

At this juncture I do not necessarily favor one approach over the other, but I believe this technical drafting matter may warrant further study.

The second amendment to the Commodity Exchange Act proposed by the GAO would insure that no gaps in regulatory responsibility would result by excluding certain securities from the definition of "commodity."

In effect, the amendment would divide the area into three parts—futures on tangible commodities and services, futures on securities subject to registration under the Securities Act of 1933, and futures on securities—for example, Treasury bills—that are exempt from the 1933 act's registration requirements.

The amendment would make clear that the CFTC retains responsibility for futures traded on tangible items and services encompassed by the definition of "commodity."

Those items would include traditional commodities which are properly within the regulatory ambit of the CFTC. And, by otherwise retaining the broad definition of "commodity," the amendment would enable the CFTC to continue to respond creatively to the market's call for new risk management devices.

As to futures on securities subject to registration under the Securities Act of 1933, the GAO amendment would make clear that those futures are themselves "securities" subject to the full panoply of the Federal securities laws administered and enforced by this Commission.

As mentioned, we support the concept of vertical integration of regulatory responsibility and this proposal would accomplish that result.

As to futures on exempt securities, such as Treasury bills, the proposed amendment would clarify that the CFTC would continue to exercise regulatory responsibility with respect to those futures while allowing the Commission to bring antifraud actions.

In this area, the Commission believes that serious consideration also should be given to accommodating the interests of those Federal agencies which now have responsibility over the cash markets in Government securities. It is only through such a carefully coordinated approach—coupled with a meaningful opportunity for concerned Federal agencies to bring their expertise to bear on the regulatory process—that we can assure the continued vitality of this important national asset.

The third amendment to the Commodity Exchange Act proposed by the GAO in 1978 would create a "Council on Regulation of Securities Futures" comprised of representatives of the Department of Treasury, the Commission and the CFTC, and other interested Federal agencies designated by the President.

The Council would have no direct regulatory responsibility but would make recommendations on particular futures contract applications to the appropriate agency before which the contract may be pending. I believe that establishment of a council of this sort would be salutary, but only if done as a supplement, rather than as an alternative, to the legislative scheme I have outlined above.

In a third area of inquiry, the subcommittee has asked that I discuss the possible effects on the securities industry of a corner on an underlying cash commodity or manipulation of a particular futures contract. The answer to this question depends, in large measure, upon the nature of the underlying commodity.

I might note that this is not a very simple area to deal with.

Now, where the underlying commodity is a security, a "corner"—more properly described in securities parlance as an attempt to acquire control over an outstanding class of securities—may actually further a legitimate economic activity—if, for example, the security is acquired pursuant to a tender offer, issuer repurchase or other acquisition program conducted in accordance with existing statutory and regulatory requirements.

Where futures are traded on a security, however, it is conceivable that sizable acquisitions of the underlying security may be attempted to "squeeze" persons who hold short positions in the futures contract.

If successful, acquisitions of this type could increase the price of the underlying security in response to a contrived imbalance in supply and demand. As the available supply of the underlying security is diminished, those seeking to cover short positions in the future will be forced to pay an inflated price.

If the investor in the acquisition program changes his investment strategy in the underlying security, or worse, only took a position in the underlying security for a manipulative purpose, when the securities are released back into the market, there may likely be a precipitous drop in price to the detriment of investors who bought the security at the price affected by the acquisition program or manipulation.

Moreover, those customers who financed the initial purchase of their securities will be required to deposit additional margin. If customers fail to meet maintenance margin calls, brokers will be required to liquidate their customers' positions and, in so doing, may incur losses if proceeds from these sales fall short of the sums originally lent to their margin customers.

With respect to manipulation of a futures contract on a security, if the price of the future is manipulated upward, those who hold short positions on the future will be required to deposit additional margin, and, when the futures contract returns to a bona fide price, those who bought at the inflated price will be required to post margin or sell at a loss.

To the extent that purchasers or sellers fail to meet margin calls, losses may be incurred by their brokerage firms who must cover their customers' defaults.

Moreover, to the extent that prices of futures on securities influence the price of the underlying securities, additional losses may be incurred by investors in the cash markets.

Where corners occur in tangible commodities and services and manipulations take place in their respective futures, the effects on the securities markets and the brokerage industry will be less direct, though potentially significant.

Most importantly, as the March silver trading experience demonstrates, the use of securities as collateral in commodities accounts effectively links, in certain respects, the commodities and securities markets.

If a commodities customer fails to deposit additional collateral to meet a margin call, the brokerage firm must liquidate the securities collateral, which may drive down the price of those securities.

If the proceeds are insufficient to meet margin calls, the brokerage firm may sustain losses which, in turn, may put the firm in net capital violation.

Finally, on a more general level, disruptions in the futures markets and threats to the solvency of brokerage firms can only serve to undermine investor confidence in the markets as a whole.

I thank you again for the opportunity to address this subcommittee, and I shall be happy to respond to any questions.

Mr. ROSENTHAL. Thank you very much, Mr. Chairman.

Why don't you go ahead and proceed with the questions that we have given to you?

Mr. WILLIAMS. Mr. Chairman, this is obviously an extensive and very thoughtful list of questions.

Mr. ROSENTHAL. It was my understanding that these questions had been delivered to members of your staff on Thursday and Friday.

Mr. WILLIAMS. We had some general idea of the areas that you would be covering, but I did not have the specific questions.

Mr. ROSENTHAL. Why don't you do the best you can and we will leave the record open?

Mr. WILLIAMS. Fine.

You ask first for a description of the requirements imposed upon market professionals by the Federal securities laws to contribute to the maintenance of fair and orderly markets. These requirements have been implemented through very specific obligations on both market professionals and market centers. For example, professional dealers are required not only to refrain from creating or aggravating unwarranted temporary disruptions in supply and demand, but we also affirmatively commit their capital to promote fair and orderly markets.

Aside from the statutory provisions in the Commodity Exchange Act and rules adopted thereunder by the CFTC barring outright manipulation of prices, it is my understanding that the CFTC does not have comparable rules concerning fair and orderly markets. The theory underlying these rules obviously is that market professionals should, in effect, trade counter to public buying or selling trends thereby maintaining a balance and order in the marketplace rather than exacerbating any dysfunction in the market.

With respect to your question on the banks and brokerage firms, all I can say is that, I don't know anything about the Federal Reserve Board's activities referred to in your question. If these actions are purported to have been discussed in the meetings I attended, this is another unreliable "reliable source."

Mr. ROSENTHAL. Question 1 referred to a story that appeared in the March 31, 1980, issue of the Wall Street Letter which suggested that the Federal Reserve stepped in and put up some of the cash after the emergency meetings.

Do you know whether that is true or not?

Mr. **Williams**. To be absolutely sure, I would urge you ask the Fed, but I am quite sure that it is not true.

Mr. **Rosenthal**. To the best of your knowledge, the Fed did not provide any money to any brokerage house?

Mr. **Williams**. That is true—nor to anyone else involved in this.

Mr. **Rosenthal**. Did they provide other instruments of debt, letters of credit or anything like that?

Mr. **Williams**. I am quite sure they did not.

Mr. **Rosenthal**. Did they do anything to assure the liquidity of these brokerage firms?

Mr. **Williams**. No, sir, not to my knowledge.

Mr. **Rosenthal**. And presumably you would know that?

Mr. **Williams**. I would be very surprised if I didn't know it. I am quite confident that nothing of that sort occurred.

The second question asks for details of all meetings in which the SEC and the Fed were involved from March 24 through April 14, who was present and what decisions were reached and at which meetings were bank loans discussed.

I am not prepared for this question. There had been a number of meetings and beyond that a number of telephone communications.

Mr. **Rosenthal**. Could you describe, Mr. Williams, the character or the tenure of the meetings, the first, second, and third one? We are trying to assess the seriousness of the situation. One way we can get it is from a reflection of your attitude.

Mr. **Williams**. Fine.

The first meeting I was involved in—which I believe was the first meeting governmental agencies were involved in—was Wednesday afternoon, the 26th. I arrived at the meeting at about 2 o'clock. It lasted until about 6. The meeting was in a sense a reflection of one of the underlying problems in this whole series of events—that is, we were trying to get the facts. I might note that I think a good part of what happened in the marketplace, particularly on Thursday and particularly in relation to the securities markets themselves, was that no one was quite sure what the facts were.

I might say that it is still even somewhat unclear.

Mr. **Rosenthal**. One fact that you did understand was that some events in the commodity markets had triggered an after-event in the security market. That was indisputable.

Mr. **Williams**. What we knew was that Bache had made a margin call on the Hunts which the Hunts had not honored. Apparently this is the first time it had happened.

Mr. **Rosenthal**. If the scenario had played out the other way, and the Hunts were not able subsequently to honor their margin calls, we are interested in what your speculation would be as to what would have happened to the security markets. That is what we are really worried about, and a whole host of organizational changes that are obviously necessary.

Mr. **Williams**. Governmental?

Mr. **Rosenthal**. In other words, ongoing communication—since up to that moment your agency and the CFTC and the Federal Reserve had never before coordinated either interests or activities.

Mr. **Williams**. No, that is not accurate. We had not had a crisis of this sort that we had to respond to, but I might say it is awfully difficult to establish a system that is adequate or appropriate to a crisis.

When a crisis arises, you man the boats in whatever form necessary. I had a number of meetings, as did my staff.

Mr. ROSENTHAL. But there had been no ongoing relationship between the various interested agencies?

Mr. WILLIAMS. Yes, there had been. There were a number of activities ongoing between members of the Commission and staff of the SEC and the CFTC.

Mr. ROSENTHAL. Had the CFTC been giving you information on a regular basis prior to that?

Mr. WILLIAMS. I don't recall any specific requests for information.

Mr. ROSENTHAL. When we asked you that same question 10 days ago, have they been giving you information on a regular basis, you answered, "Not that I am aware of, no."

Mr. WILLIAMS. That is still correct, but I don't recall anything specifically that we asked them for.

Mr. ROSENTHAL. I don't want to belabor that point.

The understanding I had is that one could not characterize the nature of the relationship between the various responsible agencies as an ongoing informative, cooperative and responsive one. Was it?

Would you characterize it that way?

Mr. WILLIAMS. I can't give you a clear-cut answer on that. I would say, Mr. Chairman, when I came to this agency——

Mr. ROSENTHAL. You know what you are doing; you are bifurcating. Safire is going to have a column on that word, "bifurcating."

Mr. WILLIAMS. When I came to the SEC, Mr. Chairman, I found that the working relationships between the Commission and, for example, the banking regulatory agencies left a lot to be desired. It did also with the CFTC.

I think we are working together better at this point than we have. I think there are instances where we are able to undertake joint investigations. Is there an easy flow of information from one agency to the other? Not typically, no.

Mr. ROSENTHAL. I am not trying to personalize this situation.

Mr. WILLIAMS. I think we are working together more fluidly than we have, and in the last couple of months we have worked together very effectively.

Mr. ROSENTHAL. When this is all over, we are going to have a much better system, aren't we?

Mr. WILLIAMS. I would hope so.

Mr. ROSENTHAL. If the Hunts were not able to cover, it could have had an extraordinarily negative impact on the securities markets? That is what we want to know.

Mr. WILLIAMS. That is right.

Mr. ROSENTHAL. I hate to use words like disaster, but the possibility for serious impact was very real.

Mr. WILLIAMS. Yes, sir, it was.

Mr. ROSENTHAL. In a sense that is what you were trying to deal with in this coordinated group.

Mr. WILLIAMS. That is correct.

Mr. ROSENTHAL. That is what the question is. Who was there and what kind of contribution they made? Was the Federal Reserve

Chairman, Mr. Volcker, the lead person in convening and establishing the pace for these meetings?

Mr. **Williams.** The first meeting occurred at his office at his invitation. He received the first piece of information indicating there was a problem. He rang the bell, and we got together.

Mr. **Rosenthal.** Had Volcker not done that, were you prepared to ring the bell?

Mr. **Williams.** I am sure I would have heard about it very shortly thereafter; and, yes, I think whether I or any of the other agencies heard about it, the same event would have happened.

Mr. **Rosenthal.** Why don't you go to question No. 4?

Mr. **Williams.** Question 4, the Washington Post, April 10, 1980, reported that banks and brokerage houses loaned the Hunts millions of dollars to finance their silver speculation.

What kinds of loans are actually prohibited or restricted by present SEC or Fed guidelines?

I will have to come back to you on that one. I can turn it around another way. At this point I am not aware that any of the loans, at least that I am aware of, with the brokerage houses were in violation of either SEC or Fed guidelines.

Mr. **Rosenthal.** But the Hunts were in fact financing their speculative interests through loans from brokerage houses.

Mr. **Williams.** In part.

Mr. **Rosenthal.** Obviously a significant part in terms of hundreds of millions of dollars.

Mr. **Williams.** That is right.

Mr. **Rosenthal.** What motivated that question was the story that appeared in the Washington Post on April 10 that said since last October Federal Reserve Board Chairman Paul Volcker has been urging lenders not to make loans for speculative purposes. What I want to know is, are there any restrictions on loans for speculative purposes that you know of?

Mr. **Williams.** Well, the margin rules applicable to trading in securities require that, in effect, you cannot borrow to put up your initial margin. That has to be your own capital. So that is probably the most important provision against speculations in securities.

Mr. **Rosenthal.** Let me refine that a bit. If silver is put up by a brokerage firm as collateral, can the same brokerage house use that silver as collateral for bank loans to fund future speculations?

Do I make myself clear on the question?

Mr. **Williams.** Yes.

As a practical matter, there are two pieces to this. One, in part the answer is yes, to the extent that silver is or that any kind of security or other kind of collateral is placed as collateral, it can then be utilized by, as I understand it, by the broker-dealer or whoever, to borrow.

Mr. **Rosenthal.** As I understand it, the Hunts bring the silver in to Bache and get a loan. Bache then takes the silver and gets a loan on the silver.

Mr. **Williams.** That is right. But that is where Bache gets the money that it loans.

Mr. **Rosenthal.** I understand that, but the silver is being used to pyramid in a sense. The same physical quantity of silver is pyramiding a number of loans.

Mr. Williams. To the extent that the value of the silver increases—whether they in turn borrow from the bank or not—it then serves as collateral for additional purposes, that is right.

Mr. Rosenthal. But what the Hunts then did was in effect built an upside down pyramid. Isn't that correct?

Mr. Williams. To some extent. I don't know how big it was at this point, but yes, in principle.

Mr. Rosenthal. Apparently it was big enough to cause us to have this meeting.

Mr. Williams. That is right.

Mr. Rosenthal. Are there any rules against that or should we consider, or should you consider rules against that, or should somebody do something about it?

Mr. Williams. As I indicated the last time I was before you, I do believe there should be margin rules for commodity futures trading and I believe they ought to be posted by the Federal Reserve Board.

Mr. Rosenthal. What is happening in that regard?

Mr. Williams. I don't know. You would have to ask Mr. Volcker. I know that they are looking at it. I know that they are working on something of that sort.

Mr. Rosenthal. This is the part that troubles me. You have a deep and abiding interest in whether or not they take action in this area, is that correct?

Mr. Williams. That is right.

Mr. Rosenthal. Do you intend to ever ask Volcker what he is doing?

Mr. Williams. I have.

Mr. Rosenthal. What does he say?

Mr. Williams. I know they are working on it. I think you ought to ask him.

Mr. Rosenthal. The informal interagency group that began meeting on Wednesday, are they going to continue meeting?

Mr. Williams. We have been meeting and I expect it will continue. It will continue on at least several levels.

We are coordinating our investigation. Beyond that, we are looking at the consequences and what needs to be done on a regulatory level and what legislative recommendations we ought to make.

Mr. Rosenthal. OK, why don't you go on to the next page? We were reading here a little booklet put out by Merrill Lynch, the Merrill Lynch Guide to Speculating in Commodity Futures. It says in here, "Don't build pyramids upside down. Establish positions first."

Then the paragraph begins:

> Pyramid with care. Even more important is how you pyramid. It should be done so as to form a normal pyramid; that is, your largest commitment should be your first one with additions always being smaller of no more than the size of the original.

But what the Hunts did was build an upside down pyramid that was larger on top. We hope to get this information from them directly. Then we will all learn how it is done.

Why don't you talk somewhat generally about the questions on the next page? You see, what we are trying to get at, Mr. Williams, is, we have a very high regard for your organization and yourself personally. We are trying to find out how we can maximize the skill and efficacy of your Commission to make this whole system work.

Mr. **Williams.** I appreciate that.

The primary disparity that we are dealing with—I guess by implication you are asking about disparity between the rules of the two agencies with respect to margin and suitability, from the standpoint of customer protection.

There are margin requirements on securities transactions imposed by the Fed. On an option, for example, the writer of the option must, if it is an uncovered option, deposit at least 30 percent of the value of the underlying stock plus the amount that the option is in the money or minus the amount if it is out of the money.

A customer's writing of an uncovered put or call option constitutes an extension of credit by the broker to his customer, even though there may be no funds actually advanced at that time by the broker. By contrast, as I understand it, margin requirements are not imposed by the CFTC, but are actually imposed by the individual exchange or board of trade and typically, I gather, at a significantly lower level.

Mr. **Rosenthal.** Is that a good idea or a good system?

Mr. **Williams.** Well, to the extent that ours is right—and I believe it is, clearly—and I believe the regulation of margin for commodity futures is inadequate.

Mr. **Rosenthal.** That is one of the things we have to straighten out.

Mr. **Williams.** That is right.

Now, within the securities industry and related to either options or underlying equities, we have suitability requirements that require that a broker-dealer recommend to his customer only those securities transactions which it reasonably believes are suitable in light of the customer's financial position and investment goals.

We have specific suitability rules for the options exchanges. I point to them because there is a comparability between our options exchanges and the futures exchanges.

Mr. **Rosenthal.** Shouldn't they be generally running in tandem in terms of the responsibility to the customer and protection of the customers?

Mr. **Williams.** I believe so.

Mr. **Rosenthal.** Are we going to do something about it?

Mr. **Williams.** I don't know who the "we" are on that one. In terms of suitability requirements, I believe that there ought to be stronger suitability requirements.

My own personal view is that this should not be left completely to the individual exchanges.

I would hope that the CFTC would have authority. It is not clear to me whether they do or not.

Mr. **Rosenthal.** I didn't hear that.

Mr. **Williams.** Whether they have statutory authority to adopt a suitability rule. I believe they do. If they don't, they certainly should.

Mr. **Rosenthal.** Supposing they wouldn't do it or don't do it?

Mr. Williams. I think the suitability rules have to be, in my judgment, under the responsibility of the regulatory agency and the self-regulatory bodies operating under the oversight of that agency. I don't think they can be defined by Congress. Congress can direct that they impose appropriate suitability rules, which goes beyond merely giving them the power to do so. What I am saying is, I don't think we ought to try to define them by statute, but you could require by statute that they be imposed.

My judgment would be that suitability rules should be imposed on futures trading.

Mr. Rosenthal. Suppose the CFTC doesn't do that satisfactorily? What should we do about it?

Mr. Williams. I suspect if you direct them to do it, they would do it. If they don't, you would have to resort to the oversight process or transfer the jurisdiction. What we are dealing with here in both futures and options is the question of assuring that the people who get involved in playing the game can afford to take the risks involved. There are too many small investors who either believe or are sold on the idea that this is a current version of a get-rich-quick scheme. I suspect the events of the last several weeks might have chilled a good bit of that.

Nonetheless, I think we cannot rely on the kind of marketplace consequences of the last several weeks to teach investors what they should or should not speculate in.

Mr. Rosenthal. Particularly the impact on other markets.

Mr. Williams. That is right.

Now, in terms of compensation arrangements in effect, the SEC prevents or specifically prohibits market professionals from receiving a special incentive or engaging in profit participation arrangements with their customers. That is a general rule.

There may be an exception when they have their own capital up. My understanding is that the CFTC does not prohibit such performance-based fees.

In terms of the disclosure requirements for options trading and futures trading, the options clearing corporation prospectus, the OCC, as the issuer of exchange trade options, is required under the Securities Act to file a registration statement with the Commission and to publish a prospectus which is distributed by broker-dealers to all options investors.

The prospectus provides in considerable detail information specifically related to options, the various trading strategies, margin requirements, tax aspects, and so forth.

These prospectuses are particularly tailored to be informative to people who might anticipate engaging in options trading and they are required to be delivered to investors.

My understanding is that the CFTC publication is a much more generic one than is ours. It does not address the particular attributes of trading in certain types of futures.

As far as advertising is concerned, advertising on the part of exchanges or broker-dealers in options is monitored by the exchanges themselves and is overseen by the Commission.

Mr. Rosenthal. Do you think that is an effective monitoring system?

Mr. Williams. I believe it is, Mr. Chairman.

Mr. **Rosenthal**. There is a built-in conflict of interest because the exchange has an interest in doing large volume.

Mr. **Williams**. That is where the responsibility of the Commission's oversight comes in.

I would say if it were not for the Commission oversight, I would be concerned about it, as we are generally about the fact that there are two aspects to the exchange.

Mr. **Rosenthal**. The whole system is inherently incestuous.

Mr. **Williams**. Mr. Chairman, I think if we go back to the 1934 act, the concept by which the Commission was structured has turned out to be, I think, a very appropriate one.

I don't know who deserves credit for the ingenuity involved, but the concept of self-regulation coupled with effective oversight confers upon the private sector the primary responsibility for dealing with many of these issues where they do have a particular awareness of the problem. But it will only work with effective oversight, recognizing the conflict inherent in self-regulation. Because at the same time that the individual exchanges are in competition with each other and are dependent upon the broker-dealers and market professionals who bring business to the floor of those exchanges, they are responsible for regulating and disciplining those same market makers and broker-dealers.

Mr. **Rosenthal**. That is inherently a conflict of interest?

Mr. **Williams**. It is a conflict, yes, it is.

Mr. **Rosenthal**. You would have a right to be aggrieved if these folks, the two commodity exchanges, don't do their job and they upset your markets?

Mr. **Williams**. Yes, sir.

Mr. **Rosenthal**. In that sense you are aggrieved?

Mr. **Williams**. That is right. Going back to your premise here of unequal regulatory schemes—to the extent that we are dealing now not with silver itself, where the consequences to the securities industry is relatively secondary but still powerful—to the extent we are dealing with securities options versus securities futures, we are very distinctly aggrieved to the extent that the regulatory schemes are unequal and to the extent that the other regulatory scheme is in our judgment, inadequate.

Mr. **Rosenthal**. We have done a lot of researching to see whether a President recognized these things. The only quote we could find was a comment made by Franklin Roosevelt on March 26, 1934, in a message sent to Congress in which he said, and I quote:

> The people of this country are in the overwhelming majority fully aware of the fact that unregulated speculation in securities and in commodities is one of the most important contributing factors in the artificial and unwarranted boom which had so much to do with the terrible conditions of the years following 1919.

What we worry about is that unwarranted speculation in silver could produce the same kind of scenario. We would hope that all the regulatory agencies and the Congress respond affirmatively to this challenge. I know that you feel the same way?

Mr. **Williams**. I do.

Mr. **Rosenthal**. The question is, How do we do it?

Mr. **Williams**. Well, as I indicated in my opening statement, from the regulatory side—I see there are some questions here that will bring us to that—we are looking at specifically what we ought to be doing internally to that capital role and otherwise.

In terms of the legislative aspects on margin, I believe margin should be required.

In terms of regulatory schemes, as I indicated last time, I believe there should be a suitability rule. I believe there should be limitations on the number of contracts. There should be position limits. Those can and should be administered by the regulatory agency that is responsible, and, in some cases, by self-regulatory bodies operating under the active oversight of that agency.

Mr. ROSENTHAL. Have these commodity exchanges been used principally for speculative purposes?

Mr. WILLIAMS. No, sir. I can't give you a lengthy history. I was involved with at least one of the commodity exchanges myself in the sixties, involved in hedging commodities on soy and cotton seed. The board of trade originated largely as a price discovery and hedging mechanism and served a very valuable purpose in that regard.

Looking at the price of October wheat, you find that in the commodity markets—the future markets, not in the spot market——

Mr. ROSENTHAL. Did the same kind of considerations go into October wheat markets as into the silver markets?

Mr. WILLIAMS. No, sir, they do not and——

Mr. ROSENTHAL. That is what I am trying to——

Mr. WILLIAMS. I think part of what we are trying to figure out is how far does that distinction go. We have some learning to do in this area. Clearly with precious metals there are other values, different kinds of portability, different implications in terms of financial markets, than the price of wheat. You are dealing with a totally different kind of commodity.

Mr. ROSENTHAL. I think there is inherently a whole series of distinctions. There is also a distinction if somebody can't take October wheat to Bache & Co. and get loans to pyramid.

Mr. WILLIAMS. I suspect they can.

Mr. ROSENTHAL. Do they do that?

Mr. WILLIAMS. October wheat doesn't move the way silver did.

Mr. ROSENTHAL. Exactly.

Mr. WILLIAMS. They do, yes, but there is not that much opportunity.

Mr. ROSENTHAL. When you put silver up with Bache do you physically carry it in?

Mr. WILLIAMS. No. Warehouse receipts, are used.

Mr. ROSENTHAL. And with wheat presumably you do the same thing?

Mr. WILLIAMS. Yes, sir.

Mr. ROSENTHAL. I would think it is not quite the same in terms of currency.

Mr. WILLIAMS. In terms of liquidity they are the same. But in terms of value as a currency, they are not the same clearly, and silver—certainly gold even more so——

Mr. ROSENTHAL. What we are trying to understand are the enormous differences between commodities like agricultural products and precious metals.

Mr. WILLIAMS. Clearly I think the response has to be different because the responsibility is different. There had been efforts to corner commodities and futures, but they haven't had the kind of secondary consequences we are concerned with here.

Mr. ROSENTHAL. Why don't you skip the section called Securities Options on the bottom of the page and submit it for the record, and make sure you do it for the record?

Mr. WILLIAMS. Fine.

[The information referred to is on p. 88.]

Mr. ROSENTHAL. Go to the next one called Net Capital Rule.

Mr. WILLIAMS. The introductory statement states that the net capital rule has been called an investor's best protection since it requires brokers and dealers to maintain a certain specified minimum net capital—cash or liquid assets—to protect the positions carried in their customers' accounts. The thrust of the rule is to insure that a broker or dealer has sufficient liquid assets to cover current indebtedness.

Now, let me try to pick up several of your questions here. The current version of the Commission's net capital rule was last reviewed extensively approximately half a dozen years ago. The nature of the securities markets themselves has, even before the silver situation, changed substantially since that time, and the SIA proposal that you referred to was in part responsive, in fact primarily responsive, to my request to them that they review the condition of the industry, the changes in the industry, the applicability of the net capital rule and its bite, if you will, and make recommendations as to how they think it ought to be changed.

At the same time, we are now in the process of putting together a very comprehensive review of the rule within the Commission itself. To give you a couple of highlights: The total equity capital of New York Stock Exchange member firms in dollars, is virtually the same now as it was half a dozen years ago, a decade ago virtually, and during that same period, of course, we have inflation to take into account.

At the same time, the revenues from brokerage commission business on securities has dropped as a result of the U.N. fixing of commission rates, and the amount of revenues related to margin loans has grown in importance as a source of income to the securities industry, as has market making, and investments for their own accounts, which are much more risky than certainly was the income derived from the commission business. The whole mix of business of the securities industry, and the amount of concentration in the industry, has changed significantly. Moreover, there are far fewer underwritings today than we had a decade ago.

Mr. ROSENTHAL. Have you recommended a change in the net capital rule?

Mr. WILLIAMS. No, sir.

Mr. ROSENTHAL. Have you been thinking about it?

Mr. WILLIAMS. We have in relation to this specific problem.

Mr. ROSENTHAL. Generally?

Mr. WILLIAMS. Generally we are in the process of looking at the rule to determine the effect of the rule—not to determine what changes, if any, ought to be made, and I have no prejudgments in terms of what direction any changes may take.

Mr. **Rosenthal**. Take the case of Bache, a principal in this situation. They reported contingent liabilities as of October 31, 1979, of $80 million and double that amount 3 months later. Does that suggest anything to you at all?

Mr. **Williams**. I would have to know what they are about. Obviously it is a matter that is of interest, but I really am not in a position to comment.

Mr. **Rosenthal**. If there were a brokerage house that has $80 million contingent liabilities and in 3 months it was $160 million, does that mean anything?

Mr. **Williams**. I would have to know what those contingent liabilities are. I would have to know what underlies them.

Mr. **Rosenthal**. They were bank letters of credit, I am told, in lieu of margin deposits. Bank letters of credit in lieu of margin deposits. Does that mean anything?

Mr. **Williams**. I will have to come back to you on that. I am not sure what it means.

Mr. **Rosenthal**. Would it mean they are in a shaky position? That is what it seems to me.

Mr. **Williams**. I don't know. I cannot work through the net capital rule from memory to know how that fits in. I will have to come back to you.

Mr. **Rosenthal**. Would you look into that, because that worries us, that $80 million ballooning there. You will look into that and let us know?

Mr. **Williams**. Certainly.

[The information referred to is on p. 94.]

Mr. **Rosenthal**. Go to the next page, if you would like to.

Why don't you do the next page for the record, questions, 6, 7, and 8, and go to the last page, SIPC.

[The information referred to is on p. 96.]

Mr. **Rosenthal**. If a major brokerage firm had failed and liquidation been required, how would the temporary freezing of assets, including futures contracts, pending final liquidation, have affected commodity prices and trading?

Mr. **Williams**. Well, what we are involved with here is the question of the orderly transaction of business or liquidation when——

Mr. **Rosenthal**. Would you have frozen the contracts that had to be liquidated?

Mr. **Williams**. I don't know what specifically we would do under those circumstances. My guess is that there would be some slippage while a receiver was being appointed. But once the receiver is appointed, we would have an emergency situation in which he would continue to liquidate the positions. But there has to be some slippage in that kind of process. The delay, I would think, would be brief, but in a market like we had that week, even brief delays could be disastrous.

During a liquidation, how would the Securities Investor Protection Corporation treat commodity futures customers of a brokerage firm as compared to securities customers?

Their coverage is limited to securities customers.

If a major commodity brokerage firm such as Conti-Commodities or ACLI had failed, would its investors have protection similar to those afforded investors by SIPC?

I am quite sure they would not but I don't know where it would come from. There is nothing in the SIPC Act to protect those customers.

SIPC—the Securities Investor Protection Corporation—has recommended that Congress substantially increase protection for customers who keep their securities with brokerage firms, including raising limits for customers' cash claims to the same level as the planned increase for depositors in banks and savings and loans. Do you favor the increase? What is the present status of the recommendations?

We do favor the increase, and I believe it has been submitted to Congress.

Mr. ROSENTHAL. Mr. Deckard.

Mr. DECKARD. Thank you, Mr. Chairman.

Mr. Williams, I would like to make reference to a letter dated February 19 from the Securities and Exchange Commmission to Mr. Stone of the Commodities Futures Trading Commission, with reference to the application of the Kansas City Board of Trade for contract market designation in a future based upon the Value Line stock market average. I understand there are a number of others.

In the letter there are a number of concerns that are expressed for investor protection and unfair competition among markets and market professionals. The reservations include the economic purpose of the proposed contract, the risks to investor protection, the potentially adverse impact on the underlying markets.

I wonder if you would elaborate on these concerns, particularly as they may be applicable to the lack of investor protection apparent in the silver fall?

I would ask you to stand by the recommendations in that letter which is signed by Mr. Pollack.

Mr. WILLIAMS. Yes, sir. This letter, as I have indicated, was our communication to the CFTC on the question of whether the Value Line stock market average future should be approved for trading on the Kansas City Board of Trade. In the process, we do contrast the regulatory schemes of the two agencies and I do stand by the letter and by its contents. It is a very difficult letter to summarize. Our growing concern, apart from the question of whether there is any economic purpose to be served by such a future on an average, which is the concern we still have, is that there is a basic difference in regulatory philosophy between the two commissions.

Part of that may stem from our enabling legislation or our legislative responsibility per se. Part is a matter of regulatory philosophy, and in this letter we go through in very extensive detail the various aspects—from customer protection, margin requirements, suitability standards, the responsibilities of market makers, limitations on what they can and cannot do, and the extent of self-discipline within the self-regulatory process itself, and Commission oversight of that process.

We also refer in here at some length to the options study and recommendations which we made, that were primarily aimed at the protection of investors. The disparities between the approaches of the two agencies and the regulatory oversight are rather tremendous.

Mr. DECKARD. Apparently there is no obligation on the CFTC's part to respond to that letter. Have you had any indication formally or informally as to their attitude toward the recommendations made, or the concern you have expressed, and do you have any indication what the ultimate action may be with respect to the application?

Mr. WILLIAMS. My understanding, Congressman Deckard, is that the matter is still under consideration at the CFTC. The precise status at this time I am not certain, but I am informed they have taken our concerns very seriously. I have no reason to believe that they are addressing our concerns from the standpoint of changing their own regulatory scheme but I know at least Chairman Stone is of the view that whether a future or an option is involved, they ought to be subject to the same quality of regulation, and that is certainly a principle that we agree with.

Mr. DECKARD. I would ask that this letter from the SEC to the CFTC be placed in the record.

Mr. ROSENTHAL. Without objection.

[The information follows:]

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE COMMISSIONER

FEB 19 1980

Honorable James M. Stone
Chairman
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D.C. 20581

Re: The application of the Kansas City Board of Trade for contract market designation in a future based upon the Value Line Stock Market Average.

Dear Chairman Stone:

By letter dated December 4, 1979, the Commodity Futures Trading Commission ("CFTC") requested the Commission to comment on the application of the Kansas City Board of Trade ("KCBT") for contract market designation in a future based upon the Value Line Stock Market Average.

The Commission has a strong regulatory concern with respect to the trading of any derivative instrument which may affect the capital formation process, or the integrity and orderliness of the secondary markets for equity and debt securities and other derivative instruments. [1] Accordingly, the Commission appreciates the opportunity to submit these comments on the KCBT application. As you know, the Commission on two prior occasions has apprised the CFTC of its views with respect to an earlier application of the KCBT for contract market designation in the Dow Jones 30 Industrial Stock Average. [2] In our letter of August 21, 1978, the Commission expressed reservations concerning the economic purpose of the proposed contract, the risks to investor protection, the potentially adverse impact on the underlying equity markets, the effects of unequal regulation, and the jurisdictional issues posed by the trading of stock index futures. And, in written testimony on October 25, 1978, the Commission expressed concern over a number of regulatory disparities applicable to stock options and stock index futures. Drawing upon the Commission's Special Study of the Options Markets then underway, our testimony discussed the additional surveillance and other regulatory problems which are posed by the trading of derivative instruments such as stock index contracts.

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[1] In recognition of this regulatory concern, Congress in the Futures Trading Act of 1978, Pub. L. No. 95-405 (Sept. 30, 1978), amended the Commodity Exchange Act to require the CFTC to consult with the Commission, as well as with the Department of Treasury, and the Board of Governors of the Federal Reserve System, with respect to CFTC activities that relate to the responsibilities of each respective agency. Commodity Exchange Act § 2(a)(8)(B), 7 U.S.C. 4a(g)(2)(i).

[2] Letter from Irving M. Pollack, Commissioner, Securities and Exchange Commission to William T. Bagley, Chairman, CFTC (Aug. 21, 1978); Prepared Statement of Ralph C. Ferrara, General Counsel, Securities and Exchange Commission (Oct. 25, 1978).

The KCBT's revised stock index contract differs, in some respects, from the earlier contract upon which the Commission commented. The revised contract substitutes the Value Line Stock Average for the Dow Jones 30 Industrial Stock Average; deletes speculative position limits; raises customer margin requirements for "hedgers" from $1,000 to $2,000 and for "speculators" from $1,500 to $4,000; and provides only for cash settlement, eliminating the alternative of accepting delivery of shares of stock. Notwithstanding these modifications, the revised contract gives rise to many of the concerns which the Commission earlier expressed.

In our comments here, we first discuss some of the regulatory disparities which attend the trading of financial futures and the trading of securities, and the problems which are likely to result where functionally similar instruments, such as stock index contracts and options, are subject to differing regulatory schemes. The implications for investor protection are further developed in our discussion of self-regulatory improvements implemented or underway in the securities options markets following recommendations of the Commission's Options Study. Finally, we touch upon a few of the questions raised by the KCBT contract under the Commodity Exchange Act — the economic purposes to be served by the contract and the failure to provide for the opportunity of delivery of an underlying commodity.

In sum, the Commission believes that approval of the KCBT contract, at this time, would raise serious questions of investor protection and unfair competition among markets and market professionals. Before trading in stock index futures is permitted to commence, the Commission believes that additional study remains to be done to reach a more complete understanding of the interdependencies of the equities market and derivative markets, and the types of coordinated surveillance and oversight mechanisms necessary to ensure the integrity of these markets. Through this approach, the CFTC, the Commission and other interested agencies, should be able fully to assess the implications of unequal regulatory schemes, and to reach informed judgments about the extent to which regulatory disparities must be eliminated before trading in a stock index contract is permitted to begin.

I. Regulatory Disparities in the Trading of Index Futures and Securities Options

As we have noted in our earlier comments, financial futures, such as stock index contracts, are functionally similar, in many respects, to options on securities. Both stock index contracts and options enable investors to transfer the risk associated with holding a position, either long or short, in underlying securities. Both stock index futures and options are derivatively priced, reflecting the prices of securities traded in the underlying capital markets. And, both stock index contracts and options lend themselves to highly speculative and risky trading, offering investors an opportunity for large profits but, at the same time, exposing investors to substantial losses. We recognize that there are some differences between options and financial futures. 3/ But, given these basic functional similarities, we are concerned that the same persons who now invest in options, or are prospective investors in options, will become the special focus of those promoting trading in a stock index contract. Thus, the need for investor protection for those who invest in stock index contracts appears as great as for those who invest in securities options.

Under the Commodity Exchange Act, a board of trade, in order to obtain and thereafter maintain contract market designation, must demonstrate that transactions for future delivery in the commodity for which

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3/ For example, one who sells an uncovered call option has an unlimited "upside" risk of loss, but has a "downside" opportunity for gain limited to the premium received. One who sells an uncovered futures contract also has an unlimited "upside" risk of loss, but has a greater "downside" opportunity for gain because the futures buyer assumes the full risk of market decline.

Many differences between futures and options can, however, be eliminated by certain trading strategies. In the foregoing illustration, for example, the seller of an uncovered call option, by applying the premium received to the purchase of a put option on the same underlying security, can replicate an uncovered futures seller's potential risk/gain position.

designation is sought will not be contrary to the public interest. 4/ In applying the "public interest" standard to a contract that is functionally similar to securities options, the CFTC must carefully assess the disparities between the regulatory schemes for the trading of financial futures and the trading of securities. The presence of regulatory disparities is likely to produce a number of untoward results inimical to the public interest. As noted above, investor protection safeguards provided under the federal securities laws may be undermined if trading in a stock index future is permitted to begin under a regulatory framework that imposes different standards upon market professionals and market places. Moreover, unequal regulation is likely to distort the flow of investment capital, as market professionals enter the lesser regulated market and steer investors toward that market. Unequal regulation of functionally comparable instruments is also likely to lead to unfair competition between professionals in the futures markets and professionals in the securities markets.

An inter-agency task force comprised of staff of the CFTC, Treasury, the Federal Reserve Board, and the Commission, is presently engaged in a joint study to compare regulation of the futures and securities markets. The CFTC staff, in September 1979, and the Commission staff, in November 1979, submitted reports outlining the regulatory schemes of the Commodity Exchange Act and the federal securities laws, respectively. Also, in November 1979, the Federal Reserve Board staff submitted a study of margin regulation in the commodities and futures markets. The task force intends next to analyze the implications for investor protection and the effects on the flow of investment capital attributable to regulatory differences.

The CFTC, of course, may find it necessary to proceed in its consideration of the KCBT contract before the inter-agency task force completes its work. Nonetheless, the CFTC, we believe, should carefully weigh the implications of permitting the trading of a derivatively-priced stock index future under a regulatory framework which differs substantially from that applicable to equity securities and to securities options. In the discussion below, we address some of these regulatory disparities, focusing particularly upon stock index contracts and securities options.

4/ Section 5(g) of the Commodity Exchange Act, 7 U.S.C. 7(g). See CFTC, Advisory Guideline on Economic and Public Interest Requirements for Contract Market Designation ("Advisory Guideline No. 1") (May 13, 1975), reprinted in Comm. Fut. L. Rep. (CCH) ¶6145.

From the standpoint of investor protection, differences in margin requirements applicable to the KCBT contract and to options assume particular importance. In exercising its authority under Section 7 of the Securities Exchange Act of 1934, 5/ the Federal Reserve Board has established stringent margin regulations for securities options. No credit may be extended for the purchase of an option. 6/ Moreover, an investor who writes an option, if uncovered, must deposit at least 30% of the value of the underlying stock, plus the amount the option is in the money or minus the amount the option is out of the money. 7/ A customer's writing of an uncovered put or call option constitutes, under this provision of Regulation T, an extension of credit by a broker-dealer to his customer, notwithstanding that no funds are then actually advanced by the broker-dealer. Accordingly, the deposit by an options writer is functionally equivalent to the "good faith" deposit made by one who sells a futures contract.

By contrast the KCBT contract calls for initial margin of $2000 for "hedgers" and $4000 for "speculators". 8/ Assuming that the KCBT contract were to trade, as now estimated, at a level of about $50,000, these margin requirements would only be approximately 8-9% for speculators

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5/ 15 U.S.C. 78(g). In conferring margin authority upon the Federal Reserve Board, Congress intended not only to further macro-economic ends, but to protect investors from excessive risks incurred by trading upon little or no margin. See S. Rep. No. 792, 73d Cong., 2d Sess. 3 (1934); S. Rep. No. 1455, 73d Cong., 2d Sess. 11 (1934); H.R. Rep. No. 1383, 73d Cong., 2d Sess. 8 (1934). See also Meisel v. North Jersey Trust Co., 218 F. Supp. 274, 277 (S.D.N.Y. 1963); Remar v. Clayton Securities Corp., 81 F. Supp. 1014, 1017 (D. Mass. 1949).

6/ 12 C.F.R. 220.8(f).

7/ 12 C.F.R. 220.8(j).

8/ We note that the range of persons who would qualify as "hedgers" under the KCBT contract is so broad that many persons who take positions in this stock index contract for essentially speculative purposes will be able to avail themselves of the lower margin applicable to hedgers. The KCBT's proposed rules do not require that a "hedger" hold a broad-based portfolio. Indeed, a person may qualify as a hedger by holding only one common stock, so long as the market value of his position equals the value of the stock index contract.

and 4-5% for hedgers. 9/ In view of this low level of margin proposed by the KCBT and the CFTC's lack of direct authority over margins under the Commodity Exchange Act, 10/ the Commission is concerned that many unsophisticated investors, and many investors unable to bear the risk, will be lead into extremely risky trading in the KCBT contract, and will be exposed to substantial losses as the result of relatively modest fluctuations in the Value Line Average. 11/

The risks to investor protection posed by this highly-leveraged instrument are greatly compounded, in our view, by the absence of an enforceable suitability standard comparable to that which governs

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9/ The Board of Govenors of the Federal Reserve System recently announced its intention to promulgate margin requirements to govern trading in the KCBT stock index contract. But implementation of margin requirements may take several months to accomplish.

10/ *See* Sections 5a(12) and 8a(7)(C) of the Commodity Exchange Act, 7 U.S.C. 7a(12), 12a(7;(C).

11/ Assume, for example, that an investor deposits "speculative" margin of $4000 to purchase an index contract valued at $50,000, with the Value Line Average at 100. If the Value Line Average, at any time before contract expiration, falls only by 4% to 96, the investor will lose $2000, 50% of his initial investment. A cumulative drop of more than 8% in the Value Line Average will result in a 100% loss of initial margin and will require the investor to post additional margin if he seeks to protect his initial investment.

The KCBT asserts that the amount of fluctuation in the Value Line Average on a day to day basis has historically occurred within a range that would not totally eliminate a customer's margin in the course of one trading day. *See* KCBT New Contract Submission Economic Justification, at 19. While this may be of some import for futures commission merchants, who must sustain the loss if a customer fails to post additional margin, it may provide small comfort to the investor. As a matter of economic reality, a customer's "initial" margin is not merely a deposit to guarantee performance; as in the case of securities margin, with some leeway for daily marks-to-market, it may well constitute the *total* financial commitment which he is able or willing to make.

securities trading. The suitability doctrine applicable to securities trading requires generally that a broker-dealer recommend to its customer only those securities transactions which it reasonably believes are suitable in light of the customer's financial position and investment goals. The Commission's suitability rule requires that a SECO broker-dealer, in recommending securities trades, have "reasonable grounds to believe that the recommendation is not unsuitable for such customer after reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other information known by such broker or dealer." 12/

The suitability rules of the options exchanges reflect a recognition of the particular risks posed by options trading. For example, the suitability rule of the Chicago Board Options Exchange, Inc. ("CBOE"), in addition to requiring inquiry and suitability judgments parallel to those of the SECO rule, requires a member recommending the sale of a put or an uncovered call to have a reasonable basis to believe that the investor has "such knowledge and experience in financial matters that he may reasonably be expected to be capable of evaluating the risks of such transactions * * *." 13/ The other options exchanges have comparable suitability standards. 14/

12/ Securities Exchange Act Rule 15b10-3, 17 CFR 240.15b10-3. The National Association of Securities Dealers ("NASD") has a comparable suitability rule governing its members. See NASD Manual, Rules of Fair Practice, Art. III, Sec. 2 (CCH) ¶ 2152. Closely allied to "suitability" requirements are the "know your customer" rules of national securities exchanges, which impose affirmative requirements upon members to inquire into a customer's occupation, investment objectives and financial position. See, e.g., New York Stock Exchange ("NYSE") Rule 405, 2 NYSE Guide (CCH) ¶ 2405; American Stock Exchange ("AMEX") Rule 411, 2 Amex Guide (CCH) ¶ 9431.

13/ CBOE Rules 9.7 and 9.9, CBOE Guide (CCH) ¶ 2309.

14/ See Amex Rule 923, 2 Amex Guide (CCH) ¶ 9723; Midwest Stock Exchange ("MSE") Art. XLVM, Rule 5, MSE Guide (CCH) ¶ 2115; Pacific Stock Exchange ("PSE") Rule X, Sec. 18(c), PSE Guide (CCH) ¶ 4993; Philadelphia Stock Exchange ("PHLX") Rule 1026, PHLX Guide ¶ 3026.

The CFTC has thus far not adopted a suitability rule to govern futures trading. 15/ Moreover, the KCBT's "suitability" proposal, in our view, appears inadequate. The KCBT contract submission does not prescribe substantive suitability standards, but, instead, would have each member and its correspondents devise their own "suitability" procedures. The absence of uniform substantive standards provides each fcm with a disincentive to adopt a more rigorous in-house standard than other fcm's may adopt. The KCBT filing also lacks any explanation of how the KCBT intends to detect violations of in-house suitability rules by members and non-member correspondents, and the measures, if any, which the KCBT may take against offending fcm's. 16/ Absent effective enforcement efforts by the KCBT, there would appear to be no other remedy available, since violation by an fcm of an in-house suitability rule appears to be beyond the reach of the CFTC's disciplinary authority 17/ and reparations procedures. 18/

It has been our experience that certain compensation arrangements may provide market professionals with an incentive to recommend trades to their customers without proper regard to the suitability of those transactions. The federal securities laws and rules of self-regulatory organizations have specific provisions designed to prevent over-reaching

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15/ As one consequence, the recommendation of unsuitable trades by an associated person of a futures commission merchant cannot serve as the basis for disciplinary action by the CFTC. See In the Matter of Luizi, Fut. Comm. L. Rep. (CCH) ¶ 20,811 (April 17, 1979). Violation of the suitability rules of a securities self-regulatory organization ("SRO"), however, exposes a broker-dealer to disciplinary sanction by that SRO, see e.g., Philips & Co., 37 SEC 66 (1956); Thomas Arthur Stewart, 20 SEC 196 (1945), and to an injunctive action by the Commission. See Section 21(d) of the Securities Exchange Act, 15 U.S.C. 78 u(d). And, the Commission is empowered to bring its own administrative proceeding against a SECO broker-dealer for violation of the Commission's suitability rule. See Sections 15(b)(4), (b)(6) of the Securities Exchange Act, 15 U.S.C. 78o(b)(4), (b)(6).

16/ The KCBT does state, however, that it may eliminate its in-house suitability rule if experience demonstrates that the rule is "unnecessary." KCBT Explanation of Stock Index Futures Rules, at 17.

17/ See note 15 supra.

18/ Section 14(a) of the Commodity Exchange Act, 7 U.S.C. 18(e).

by securities market professionals and to eliminate conflicts of interest. Section 205(1) of the Investment Advisers Act of 1940 generally prohibits investment advisers from charging "performance" fees. This prohibition is based on the recognition that such a fee arrangement provides an adviser with the incentive to take undue risks with clients' funds. For the same reasons, rules of the self-regulatory organizations prohibit members or associated persons from sharing in customer profits or losses in any account carried by the member, except to the extent that they contribute capital to the account. 19/

No corresponding prohibitions, however, apply to commodity trading advisers or fcm's with respect to trading in stock index contracts. Although commodity trading advisers are required to describe their fee structure to prospective clients, 20/ neither the CFTC nor the KCBT has any rule which prohibits performance-based fees. The absence of such a prohibition, we believe, further compounds the risks posed by trading in stock index contracts.

In view of the risks associated with this untried stock index, and the likelihood that many investors will lack complete understanding of its unique characteristics, it is important that effective disclosure concerning this contract be made to investors, and that adequate controls govern the promotional efforts of fcm's and other professionals. With respect to options, for example, the Options Clearing Corporation ("OCC"), as the issuer of all exchange-traded options, is required under the Securities Act of 1933 to file a registration statement with the Commission, and to publish a prospectus which must be distributed by broker-dealers to all options investors. The OCC prospectus provides in considerable detail information about listed options, their purposes and risks, various trading strategies, the mechanics of options trading, margin requirements, tax aspects of options trading, and about the OCC itself.

Moreover, the options exchanges, subject to Commission oversight, have developed detailed standards governing the content, and manner of presentation, of options advertising by members. The CBOE, for example, by rule prohibits advertising which contains unsupportable promises, exaggerated or unwarranted claims, or unsupportable opinions

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19/ *See, e.g.*, NASD Rules of Fair Practice, Section 19(f), NASD Manual (CCH) ¶ 2169.

20/ 17 C.F.R. 4.31(a)(4).

or forecasts. 21/ Moreover, the CBOE's rules require that a member's advertisement must advise a customer of the availability of the OCC prospectus, and must alert the customer that there are special risks attendant to options trading. Any statement referring to the possible benefits of options must be accompanied by a statement of corresponding risks. To enforce compliance with advertising rules, the options exchanges require their members to submit options-related advertising for pre-clearance review. Further, each options exchange, in its routine examinations of member firms, reviews the firms' sales literature for compliance with substantive standards. All forms of advertising and customer solicitation by broker-dealers are subject to the broad antifraud provisions of the federal securities laws, which establish liability for misleading omissions and "half-truths" as well as affirmative misstatements, and under which securities purchasers and sellers may bring private damage actions.

In contrast, the risk disclosure statement that the CFTC requires an fcm to furnish prior to opening a commodity account for a customer, 22/ is a generic document, and does not address any of the particular attributes, and risks, of trading in a stock index future. Notwithstanding the unique nature of its stock index contract, the KCBT's contract submission would not require that any specific disclosure document be provided by fcm's to investors prior to trading in stock index contracts. And, the KCBT apparently has not taken the initiative to develop any disclosure document to be furnished to prospective investors in stock index contracts. Not only does the KCBT not require any specific disclosure to be made to prospective investors, but the KCBT filing, and KCBT's existing rules, do not prescribe any standards to govern member advertising and other promotional efforts. Nor does the KCBT apparently have any compliance program systematically to review member advertising. The KCBT's failure to prescribe advertising standards and review procedures raises a serious question for investor protection. Because a stock index contract is a new equity product, there is a potential for a great deal of confusion among investors, particularly those who are likely to assume that a firm which offers to trade, or advise in the trading of, stock index contracts is subject to the requirements of other firms

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21/ CBOE Rule 9.21, CCH § 2321. The other options exchanges have comparable advertising rules. See, e.g., Amex Rule 991, 2 Amex Guide (CCH) ¶ 9791; MSE Art. XIII, Rule 4, MSE Guide (CCH) ¶ 1623; PSE Rule VI, Sec. 35, PSE Guide (CCH) ¶ 4234; PHLX Rule 1049, PHLX Guide (CCH) ¶ 3049.

22/ 17 C.F.R. 1.55.

which trade in other types of "stocks" or options thereon. [23] In t regard, we are especially concerned that investor confusion will un mine public confidence generally in the securities markets.

A further disparity, which may have particular significance fo the capital allocation choices of market professionals, lies in the area of regulatory controls relating to the functioning of the mark mechanisms. Under the framework of the securities laws, for exampl the objective of "the maintenance of fair and orderly markets" has given rise to a variety of standards imposing on professionals deal at the market centers (i.e., the exchange floors), special affirmat and negative obligations to the markets. These standards, which in the options markets include a number of specific, objective criteri require that professional dealers not only refrain from creating or exacerbating unwarranted temporary disruptions in the orderliness o prices, but also require market professionals to commit their capit affirmatively to promote fair and orderly markets. Aside from the statutory prohibitions in the Commodity Exchange Act and rules adop thereunder barring outright manipulation of prices, neither the CFT nor the KCBT have rules so governing floor participants.

A final difference is the degree of industry self-regulation — an important element in an effective regulatory scheme. In the opti markets, the self-regulatory framework includes not only the options exchanges themselves, but also the underlying equities exchanges an the NASD. The NASD plays an important role with respect to options trading, since its inspection, rulemaking, and enforcement authority extends to member firms who are not necessarily members of any optic exchange, but nevertheless solicit and transmit options orders for c tomers and advise customers with respect to options trading. Thus, NASD, in its Rules of Fair Practice, has adopted standards to govern the handling of options accounts, the execution of options transactions, and the handling of orders in options by NASD members who are not also members of an options exchange. 24/

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[23] We note that the CFTC, in adopting antifraud rules under the Commodity Exchange Act, has stated that it would be "inappropri generally to adopt antifraud rules that would have a scope para to that of Rule 10b-5 under the Securities Exchange Act, since such an approach "might invite an uncritical application of sec ties principles and practices." 40 F.R. 26504, 26505 (June 24, But with respect to a stock index contract, the Commission beli that investors who purchase or sell a stock index contract shou be afforded antifraud protections comparable to those available to investors in securities options.

Section 17 of the Commodity Exchange Act, as amended in 1974, authorizes registration with the CFTC of a national futures association. And in 1978, Congress amended the Commodity Exchange Act to enable the CFTC to approve the rules of a futures trading association which provide for mandatory membership. 25/ While we are aware of recent efforts on the part of the CFTC and the futures industry to establish a futures association, no such association is now in place, and it is uncertain when such an association will be formed. Given the inability of the KCBT directly to regulate non-member fcm's, and the limited resources of any administrative agency, the absence of a registered futures association appears to leave a serious self-regulatory void with respect to non-member fcm's who solicit orders in stock index contracts and handle the accounts of customers who invest in such contracts.

The foregoing discussion illustrates, but does not exhaust, the regulatory disparities which attend trading in futures and in securities. Because a stock index contract is functionally similar in many respects to stock options, the Commission believes that these disparities raise serious questions whether approval of the KCBT stock index contract at this time is consistent with the public interest.

II. Implementation of Options Study Recommendations

As the CFTC will recall, the Commission in 1977 formed a special staff task force to conduct a comprehensive study of the standardized options markets and the adequacy of regulatory controls applicable to options trading. In January, 1979, the Commission received the report of the Options Study, 26/ and since that time the Commission and the self-regulatory organizations have been engaged in implementing

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24/ NASD Rules of Fair Practice, Art. III, Sections 1-33, NASD Manual (CCH) ¶ 2151-83.

25/ Section 17(m) of the Commodity Exchange Act, 7 U.S.C. 21(m).

26/ Report of the Special Study of the Options Markets (December 22, 1978) ("Options Study Report"), reprinted in House Comm. on Interstate and Foreign Commerce, Comm. Print 96-IFC3, 96th Cong., 1st Sess. (1978).

the Options Study's numerous specific recommendations to improve the regulatory framework for the standardized options markets. Before permitting trading in any stock index to commence, we believe the CFTC should implement, or require to be implemented, to the maximum degree feasible, improvements in the financial futures markets comparable to those being implemented in the options markets. A number of these regulatory changes are discussed below.

In accordance with a recommendation of the Options Study, the self-regulatory organizations have submitted to the Commission proposed rule changes to strengthen their suitability rules in two fundamental respects. Under the proposed rules, a broker-dealer will not be permitted to recommend any opening options transaction (whether a purchase or sale) unless it has a reasonable basis to conclude the customer is able to evaluate the risks of the particular recommended transaction. Second, broker-dealers will be required to obtain specific information bearing upon suitability before recommending any options transaction; if a customer refuses to provide necessary information which cannot otherwise be obtained, the broker-dealer is prohibited from recommending any options transaction. 27/

Many abuses arose in the options market from the failure of firms adequately to train their salesmen about the particular risks of options trading. Accordingly, the self-regulatory organizations, pursuant to recommendations of the Options Study, are now engaged in substantially revising the examinations which registered representatives are required to pass before recommending options transactions. These examinations are being designed to require a thorough understanding of options, and will be administered in a controlled environment by independent examiners. In contrast, the KCBT apparently does not propose to administer any qualifying examination to ensure that prospective fcm salesmen have even a rudimentary understanding of the stock index contract and the stock market itself.

The Options Study also recommended, and the self-regulatory organizations have proposed, rule changes to increase the supervisory duties of member firms. The self-regulatory organizations are revising the examination for supervisory officers of member firms, specifically

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27/ Options Study Report, supra, 343-345. Member organizations must maintain written suitability information which includes, at a minimum, the customer's investment objectives, employment status, estimated annual income, estimated net worth exclusive of residence, estimated liquid net worth, age, marital status, number of dependents, and his investment experience and knowledge. Id. at 354.

to test their understanding of supervisory requirements relating to options trading. The proposed rules of the self-regulatory organizations also require every member firm to develop and implement a written program for the systematic review of customer accounts and all orders in these accounts relating to options. 28/ This program must be under the supervision of a "Senior Registered Options Principal" who must be an officer or general partner of the member firm. The rule proposals also require member firms to designate a senior supervisory officer to oversee the firm's total options compliance program and to perform an audit function to determine that these activities are conducted in conformance with applicable laws, regulations and self-regulatory rules.

In previous testimony before the CFTC, we emphasized the derivative nature of both stock index contracts and stock options and the extensive interrelationship between the equities markets and derivative markets. From our experience, we have learned that the addition of a new derivative market significantly increases the potential for manipulative and unfair trading practices and for misuse of market information prior to its public dissemination. Where a new derivative market is introduced, the Commission believes that integrated surveillance and oversight is essential to ensure effective regulation.

In view of the interrelationship of the equities and options markets, the report of the Options Study emphasized the need to enhance the surveillance and investigatory capabilities of the self-regulatory organizations. The options exchanges presently have sophisticated computerized surveillance and investigatory capabilities which enable them to detect unusual market activity and to focus upon individual market participants. The CBOE, for example, monitors daily, weekly and monthly reports of all market-maker to market-maker trading, and investigates unusual price or volume patterns in trading. Extensive record-keeping requirements are imposed on market participants to create an audit trail capable of reconstructing trading activities at a later date for surveillance purposes.

28/ In specific, each member firm, through a Senior Registered Options Principal, has a duty to (1) supervise all options transactions of customers; (2) administer the firm's program for supervisory review of selected options accounts; (3) assist branch office managers in supervising customers' options activities; (4) review the acceptance of each discretionary account to determine that the supervisory officer accepting the account complied with suitability rules; and (5) review discretionary accounts frequently.

Based on the Options Study's recommendations, the Commission intends soon to consider the initiation of rulemaking proceedings to establish a centralized customer complaint registry to assist in surveillance and enforcement efforts. And in anticipation of another recommendation of the Options Study, the self-regulatory organizations have already begun a program to exchange surveillance information on a systematic basis. The New York Stock Exchange provides the options exchanges, upon request, with complete trade clearance data. To assist in detecting "front running" abuses, all equity markets routinely furnish to the options exchanges information about block transactions (including participants) in underlying securities. Finally, the options exchanges routinely share trading data with respect to multiply-traded options classes.

Implementation of these and other recommendations of the Options Study should enhance the integrity of the options markets and promote the protection of investors. The findings of the Options Study underscore the necessity for the coordination of surveillance and regulatory oversight over the equities markets and all derivative markets. With the experience gained in regulating the options markets, the Commission stands ready to work with the CFTC in this regard.

III. Issues Under the Commodity Exchange Act

A. Economic Purpose

The CFTC's Advisory Guideline No. 1 requires that a board of trade, to meet the "economic purpose" test encompassed by the public interest standard of Section 5(g) of the Commodity Exchange Act, demonstrate that a proposed contract will serve a valid price discovery purpose or will serve as an effective hedging vehicle. The Advisory Guideline states that a board of trade must show that "something more than occasional use of the contract for hedging or price basing exists, or can reasonably be expected to exist" in order to justify the economic purpose test.

We seriously question whether the proposed KCBT stock index contract serves any price discovery purpose. The underlying equities market itself reflects investor perceptions of the future returns of individual issuers, and this market is generally recognized as efficient in the sense that new information is quickly translated into appropriate price changes. In this environment, we would not expect a futures contract on a stock index to provide significant additional price discovery with regard to the stocks comprising that index.

We also question whether the holder of a portfolio of stocks could effectively use the proposed KCBT contract to hedge a stock position. Because the risk linkage between an investor's stock position and the Value Line Average is merely an imperfect statistical correlation, this "hedge" may in fact accentuate potential loss or gain if the general market (as measured by the Value Line Average) moves in a direction contrary to the "hedged" position. In this regard, we note that in recent years the Value Line Average has at times moved in inverse relation to other stock market averages such as the Standard & Poor's index, and, in any event, has not demonstrated a high, stable correlation with other indices.

A determination that the KCBT stock index contract serves an economic purpose requires, in our view, resolution of a number of corollary issues. For example, will trading in the proposed contract inject destabilizing pressures on stock prices by diminishing the depth and liquidity of the underlying equities markets? What impact will the trading of the KCBT contract have on the capital formation process, particularly with regard to the cost of capital for smaller or unseasoned issuers? And, what are the implications of recent studies on the performance of the futures market and the spot market in United States Treasury Bills which show large deviations in the returns of these two markets, contrary to the traditional theory of commodity contract pricing? 29/

At this juncture, and on the basis of the submissions made thus far by the KCBT, the Commission is not in a position to provide definitive answers to the foregoing questions. Before trading is permitted to commence, however, the KCBT should be required to answer these questions and to demonstrate affirmatively that trading in a stock index will serve an economic purpose.

B. "Non-delivery" Feature of KCBT Contract

As we have noted in our previous submissions, a futures contract on a stock index raises serious jurisdictional questions under the federal securities laws. These questions remain regardless of whether the futures contract provides for the possibility of delivery of some or all of the stocks comprising the index. But the KCBT index contract, by not providing for the delivery of the commodity underlying the contract (i.e., the stocks comprising the index), raises a serious question

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29/ See, e.g., Capozza and Cornell, "Treasury Bill Pricing in the Spot and Futures Markets," The Review of Economics and Statistics, p. 513 (Nov., 1979).

of whether a statutory prerequisite for designation as a futures contact is met.

Section 5(g) of the Commodity Exchange Act, 7 U.S.C. 7(g), which governs CFTC approval of futures contracts, requires a board of trade to demonstrate that "transactions for future delivery in the commodity for which designation as a contract market is sought will not be contrary to the public interest" (emphasis supplied). In addition, other provisions of the Commodity Exchange Act clearly contemplate delivery of the commodity underlying a futures contract as an essential element of a futures contract. For example, Section 4 of the Act, 7 U.S.C. 6, generally prohibits the execution of "any contract of sale of any commodity for future delivery," except on a board of trade registered as a "contract market"; the general antifraud provision of the Act, Section 4(b), applies to "any contract of sale of any commodity for future delivery," and the CFTC's jurisdictional grant under Section 2(a), 7 U.S.C. 2, extends, inter alia, to "contracts of sale of a commodity for future delivery."

Expansion of the definition of "commodity" by Congress in 1974 to include non-agricultural products and "all services, rights and interests" does not in any respect vitiate what appears to be a statutory requirement for delivery of the commodity underlying a futures contract. Nor is the language of the Commodity Exchange Act which contemplates delivery of an underlying commodity overcome by assertions that delivery, as a matter of economics, is not essential, or occurs infrequently. Finally, nothing in the legislative history of the amendments to the Commodity Exchange Act in 1974 and 1978 contains, in our view, any indication that Congress intended to permit the trading of contracts which do not provide for the delivery of an underlying commodity.

* * * *

We appreciate this opportunity to comment upon the revised KCBT stock index contract. If the Commission can be of any further assistance to the CFTC in its consideration of this contract, we stand ready to do so.

Sincerely,

Irving M. Pollack

Irving M. Pollack
Commissioner

Mr. **Deckard**. Mr. Williams, in the case of large brokerage firms like Bache, where the firm participates in a variety of markets, is there some way to erect an effective firewall within the firms so that if, say, the commodities operation of the firm gets into difficulty, the difficulty can be contained there and prevented from spilling over, harming clients in the securities end of the business?

Mr. **Williams**. Can they be contained?

Mr. **Deckard**. Yes. I presume this would have to be done in the legal organization of the firm.

Mr. **Williams**. Well, I think there are clearly some things that we could do in a regulatory mode that would further insulate the broker-dealer activity and the securities activity from the commodities activity, and those we will deal with very closely.

Our jurisdiction is limited to the broker-dealer, which in the case of many securities firms is one of the subsidiaries of the complex. Our jurisdiction from this regulatory mode does not directly extend to either the parent company, or, for example, the separate subsidiary that might be set up to deal in certain types of commodity loans.

We would need to look at the question whether we would want to recommend that we have jurisdiction over the entire group.

Mr. **Deckard**. Thank you.

Mr. **Rosenthal**. Thank you very much.

The matters that we didn't cover in oral presentation, they shall be included in a communication to the committee and you will keep us posted on further developments?

Mr. **Williams**. Thank you.

[The information follows:]

OFFICE OF
THE CHAIRMAN

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. [illegible]

July 18, 1980

CHAIRMAN'S OFFICE
MAILED
JUL 18 [illegible]
Signed by:

Honorable Benjamin S. Rosenthal
Chairman
Subcommittee on Commerce, Consumer and
Monetary Affairs of the House of
Representatives Committee on Government Operations
United States House of Representatives
Washington, D.C. 20510

Dear Representive Rosenthal:

During my appearance on April 14, 1980 before the Subcommittee on Commerce, Consumer and Monetary Affairs, I undertook to supplement my testimony with a subsequent response to a number of written questions which remained outstanding following my appearance. The discussion below addresses those questions, identified by your staff, which call for supplemental response.

BANKS AND BROKERAGE FIRMS

Question #2: "Detail all meetings in which the SEC and Fed were involved from March 27, 1980 through April 14, 1980. Who was present and what decisions were reached? At which meetings were bank loans discussed?"

Answer: To the extent of my personal knowledge, the following meetings with regard to the silver crisis took place:

1. On March 26, I attended a meeting with Chairman Volcker of the Federal Reserve, Chairman Stone of the CFTC, Deputy Secretary of the Treasury Carswell, and members of our respective staffs. At this meeting, we shared information on the emergency conditions in the silver futures market and discussed possible responses to the crisis.

2. On April 2, I attended a meeting with Chairman Volcker, Chairman Stone and Deputy Secretary Carswell. I believe Comptroller of the Currency John Heimann also attended. Again, we shared information on the silver crisis, and discussed possible regulatory responses.

3. On April 9, I attended a meeting with Chairman Volcker, and Deputy Secretary Carswell to discuss the silver crisis. At this meeting, Chairman Volcker advised us that a loan agreement was being negotiated by a series of banks.

4. In addition, members of the staff of the Division of Market Regulation met twice during the period of March 27 - April 3 with staff members from the Office of the Comptroller of Currency to discuss issues of common regulatory concern relating to the silver crisis.

Question #5: "Would the loan practices described above [i.e. use of silver as collateral by brokerage firms to borrow from banks to fund further speculation] encourage 'pyramid' trading? What are the advantages and risks of pyramiding?"

Answer: Such loan practices do contribute to pyramid trading when the profits that are earned from the appreciation of silver are used as collateral to finance additional futures contracts. This practice entails substantial risk when "paper" profits are used to establish increasingly larger positions without a commensurate infusion of additional equity in the account.

REGULATORY DISPARITIES AND FORUM SHOPPING

Question #1: "Discuss the general impact of unequal regulatory schemes. What are some of the present regulatory disparities in customer protection provisions for futures and securities options? How do margin requirements and customer suitability rules differ?"

Answer: As the Commission discussed in a letter to the CFTC concerning a stock index proposal of the Kansas City Board of Trade, there are significant disparities in the regulation of the securities markets and the futures markets. One significant difference is the regulation of margin. In exercising its authority under Section 7 of the Securities Exchange Act of 1934, the Federal Reserve Board has established stringent margin regulations for securities options. No credit may be extended for the purchase of an option. Moreover, an investor who writes an option, if uncovered, must deposit at least 30% of the value of the underlying stock, plus the amount the option is in the money or minus the amount the option is out of the money. A customer's writing of an uncovered put or call option constitutes, under this provision of Regulation T, an extension of credit by a broker-dealer to his customer, notwithstanding that no funds are then actually advanced by the broker-dealer. Accordingly, the deposit by an options writer is functionally equivalent to the "good faith" deposit made by one who sells a futures contract.

By contrast, neither the Federal Reserve Board nor the CFTC has any direct authority over margins under the Commodity Exchange Act. Rather, margin requirements for futures are set by the various boards of trade, generally in the range of 5 to 10 percent of the value of the contract. Thus, many unsophisticated investors, and many investors unable to bear the risk, may be exposed to substantial losses in futures trading as the result of relatively modest fluctuations in price of the underlying commodity.

The risks to investor protection are compounded by the absence of suitability standards for futures trading comparable to that which governs securities trading. The suitability doctrine applicable to securities trading requires that a broker-dealer recommend to its customer only those securities transactions which it reasonably believes are suitable in light of the customer's financial position and investment goals. Neither the CFTC nor the boards of trade have adopted suitability rules to govern futures trading.

A third area of difference concerns the promotional efforts of broker-dealers and futures commission merchants ("fcm's"). The options exchanges, subject to this Commission's oversight, have developed detailed standards governing the content, and manner of presentation, of options advertising by members. In contrast, the risk disclosure statement that the CFTC requires an fcm to furnish prior to opening a commodity account for a customer is a generic document and does not address any of the particular attributes, and risks, of trading in futures.

A fourth disparity, which may have particular significance for capital allocation, lies in the market making responsibilities imposed upon market professionals. Under the securities laws, for example, the objective of "the maintenance of fair and orderly markets" has given rise to a variety of standards imposed on broker-dealers trading at the market centers (i.e., the exchange floors), including special affirmative and negative obligations to the market. These standards, which in the options markets include a number of specific, objective criteria, require that professional dealers not only refrain from creating or exacerbating unwarranted temporary disruptions in the orderliness of prices, but also require market professionals to commit their capital affirmatively to promote fair and orderly markets. Aside from the statutory prohibitions in the Commodity Exchange Act and rules adopted thereunder barring outright manipulation of prices, the CFTC does not have rules governing floor participants.

A final difference is the degree of industry self-regulation — an important element in an effective regulatory scheme. In the options markets, the self-regulatory framework includes not only the options exchanges themselves, but also the underlying equities exchanges and the National Association of Securities Dealers, Inc. ("NASD"). The NASD plays an important role with respect to options trading, since its inspection, rulemaking, and enforcement authority extends to member firms who are not necessarily members of any options exchange, but nevertheless solicit and transmit options orders for customers and advise customers with respect to options trading. Thus, the NASD, in its Rules of Fair Practice, has adopted standards to govern the handling of options accounts, the execution of options transactions, and the handling of orders in options by NASD members who are not also members of an options exchange.

Section 17 of the Commodity Exchange Act, as amended in 1974, authorizes registration with the CFTC of a national futures association. And, in 1978, Congress amended the Commodity Exchange Act to enable the CFTC to approve the rules of a futures trading association which provide for mandatory membership. While we are aware of recent efforts on the part of the CFTC and the futures industry to establish a futures association, no such association is now in place, and it is uncertain when such an association will be formed. Given the limited resources of any administrative agency, the absence of a registered futures association appears to leave a serious self-regulatory void with respect to non-member fcm's who solicit orders in futures contracts and handle the accounts of customers who invest in such contracts.

The foregoing discussion illustrates, but does not exhaust, the regulatory disparities which attend trading in futures and in securities.

SECURITIES OPTIONS

Question #1: "How do securities options and futures compare, particularly in terms of risk to investors and speculative attractiveness?"

Answer: Futures contracts are functionally similar, in many respects, to options on securities. Both futures contracts and options enable investors to transfer the risk associated with holding a position, either long or short, in underlying securities or commodities. Both futures and options are derivatively priced, reflecting the prices of securities or commodities traded in the underlying markets. And, both futures contracts and options lend themselves to highly speculative and risky trading, offering investors an opportunity for large profits but, at the same time, exposing investors to substantial losses.

There are, however, some differences in the risk parameters of options and futures. For example, one who sells an uncovered call option has an unlimited risk of loss, but has an opportunity for gain limited to the premium received. One who sells an uncovered futures contract also has an unlimited risk of loss, but has a greater opportunity for gain because the futures buyer assumes the full risk of market decline.

Many differences between futures and options can, however, be eliminated by certain trading strategies. In the foregoing illustration, for example, the seller of an uncovered call option, by applying the premium received to the purchase of a put option on the same underlying security, can replicate an uncovered futures seller's potential risk/gain position.

Question #2: "The 'Options Study Report' (December 22, 1978), a comprehensive study of the standardized options markets and the adequacy of applicable regulatory controls, gave numerous specific recommendations to improve the regulatory framework for the standardized options markets. Would you discuss the specific recommendations and implementation to date?"

Answer: In accordance with a recommendation of the Options Study, the Commission has approved rule changes submitted by self-regulatory organizations to strengthen their suitability rules in two fundamental respects. Under the rules, a broker-dealer is not permitted to recommend any opening options transaction (whether a purchase or sale) unless it has a reasonable basis to conclude the customer is able to evaluate the risks of the particular recommended transaction. Second, broker-dealers are required to obtain specific information bearing upon suitability before recommending any options transaction; if a customer refuses to provide necessary information which cannot otherwise be obtained, the broker-dealer is prohibited from recommending any options transactions.

Many abuses arose in the options market from the failure of firms adequately to train their salesmen about the particular risks of options trading. Accordingly, the self-regulatory organizations, pursuant to recommendations of the Options Study, are now engaged in substantially revising the examinations which registered representatives are required to pass before recommending options transactions. These examinations are being designed to require a thorough understanding of options, and will be administered in a controlled environment by independent examiners.

The Options Study also recommended, and the Commission has approved, rule changes to increase the supervisory duties of member firms. The self-regulatory organizations are revising the examination for supervisory officers of member firms, especially to test their understanding of supervisory requirements relating to options trading. The rules of the self-regulatory organizations now require every member firm to develop and implement a written program for the systematic review of customer accounts and all orders in these accounts relating to options. This program must be under the supervision of a "Senior Registered Options Principal" who must be an officer or general partner of the

best copy available

member firm. The rules also require member firms to designate a senior supervisory officer to oversee the firm's total options compliance program and to perform an audit function to determine that these activities are conducted in conformance with applicable laws, regulations and self-regulatory rules.

In view of the interrelationship of the equities and options markets, the report of the Options Study emphasized the need to enhance the surveillance and investigatory capabilities of the self-regulatory organizations. The options exchanges presently have sophisticated computerized surveillance and investigatory capabilities which enable them to detect unusual market activity and to focus on individual market participants. And, extensive record-keeping requirements are imposed on market participants to create an audit trail capable of reconstructing trading activities at a later date for surveillance purposes.

Based on the Options Study's recommendations, the Commission intends soon to consider the establishment of a centralized customer complaint registry to assist in surveillance and enforcement efforts. And, in anticipation of another recommendation of the Options Study, the self-regulatory organizations have already begun a program to exchange surveillance information on a systematic basis. The New York Stock Exchange provides the options exchanges, upon request, with complete trade clearance data. To assist in detecting "front running" abuses, all equity markets routinely furnish to the options exchanges information about block transactions (including participants) in underlying securities. Finally, the options exchanges routinely share trading data with respect to multiply-traded options classes.

Implementation of these and other recommendations of the Options Study should enhance the integrity of the options markets and promote the protection of investors. The findings of the Options Study underscore the necessity of the coordination of surveillance and regulatory oversight over the equities markets and all derivative markets.

THE NET CAPITAL RULE

Introduction

There are two methods for complying with the Commission's net capital rule. The basic net capital rule requires that a broker-dealer's "aggregate indebtedness" never be more than 1500 percent of his "net capital," as those two terms are defined in the rule. It also requires every broker or dealer (other than those which do a limited securities business) to have a minimum net capital of at least $25,000. Net capital essentially means the liquid net assets of a broker-dealer reduced by prescribed percentages of the market value of securities owned by the broker or dealer and certain amounts related to firm positions in commodity and commodity futures. In addition, certain subordinated debt is added back to net worth. Aggregate indebtedness includes all the money liabilities of a broker or dealer except certain specifically described items. In essence, the rule requires a broker or dealer to have excess liquidity available to cover each dollar of his liabilities plus a cushion of six and two-thirds cents of net capital for each dollar of liabilities (including contingent liabilities).

The alternative method of calculating net capital requires a broker or dealer to maintain minimum net capital equal to the greater of $100,000 or 4% of aggregate debit items in the Formula for Determination of Reserve Requirements for Broker-Dealers ("Reserve Formula"), 17 C.F.R. 240.15c3-3a. The debit items in the Reserve Formula are assets of the firm which are secured receivables related to customer transactions. The alternative approach is based on the concept that, if the debit items in the Reserve Formula can be liquidated at or near their contract value, sufficient cash flow will exist to satisfy all liabilities to customers represented as credit items in the Reserve Formula. Election of the alternative (1) places an outer limit on a firm's abilty to increase its customer commitments to a function of its net capital and (2) insures that at least 3% of the firm's own capital in the form of secured receivables, cash or qualified securities will be devoted to providing an additional cushion so that if the debits in the Reserve Formula are not 100% collectible additional firm capital will be available to meet liabilities to customers.

The computation of net capital begins with the preparation of the statement of financial condition in accordance with Generally Accepted Accounting Principles ("GAAP"). From the net worth item of that statement is deducted various illiquid assets and other amounts set forth in the Rule.

Question #2: "Would lowering the capital requirement tend to encourage or increase speculation in the markets?"

Answer: Industry groups have recently recommended that capital requirements be reduced. The staff is reviewing their proposal at the present time but has not at this date made any recommendations of its own to the Commission.

The net capital rule is designed to limit the amount of business a firm's capital can support. Any lowering of capital requirements would have a two fold effect. First, it would allow brokers and dealers to expand their businesses on smaller capital bases. Secondly, to the extent the business did not expand, the capital that would be "freed-up" as a result of lower requirements could be utilized in other areas. In either case, increased speculation could be a result, by virtue of the ability of the broker-dealer to support more customer activity.

There is no evidence, however, to support any statement as to whether the lowering of the requirement would tend to encourage or increase speculation in the markets. If the Commission does adopt any proposals to reduce capital requirements, it will do so upon a finding that "freed-up" capital resulting from any lowering of the requirements will likely be used, among other things, to support underwriting and market-making functions.

Question #3: "Is it a purpose of the net capital rule to prevent undercapitalized firms from entering the market-place? How does this protect the public?"

Answer: The net capital rule requires brokers and dealers to maintain the greater of a flat minimum dollar amount or an amount calculated on the level of the broker's or dealer's overall business. This is to ensure that the broker or dealer always has sufficient liquid assets to satisfy customer claims promptly on demand. An undercapitalized firm may cause losses or delays to customers by not being able to meet their claims promptly.

Furthermore, a broker or dealer has many obligations which run to other brokers and dealers. The securities markets depend on all brokers and dealers being able to meet these obligations. If one firm cannot meet its obligations or fails, many other firms and their customers may be jeopardized.

The Commission's Study of Unsafe and Unsound Practices of Brokers and Dealers (House Doc. No. 92-231, 92d Cong., 1st Sess. (1971)) (the "Study") examined cases of broker-dealer failure, and found in most cases that failing firms remained in business generally less than three years. The Study, in commenting upon the protections authorized by the Securities Investor Protection Act of 1970, stated that:

> "Although the SIPC legislation does not articulate a reversal of the ease of entry policy, in light of the fact that the SIPC funds covers customers of all registered broker-dealers, the financial condition of new broker-dealer registrants will be of concern to SIPC as well as the Commission. This is particularly true since, through the Commission, SIPC may draw on the United States Treasury to the extent of one billion dollars. To permit unprepared, irresponsible parties to enter the broker-dealer business without the restraining influence of adequate entry standards would be tantamount to the subsidization of incompetent and irresponsible individuals by SIPC and the United States Treasury." Study at 164.

The Commission's net capital rule has a specific provision which helps assure the financial stability of a firm during the critical period immediately following registration. For broker-dealers operating under the "aggregate indebtedness" standard, which includes most smaller broker-dealers, the requirement during the first twelve months after commencing business is that the broker-dealer maintain an aggregate indebtedness to net capital ratio of no greater than 8 to 1 as opposed to the normal requirement of 15 to 1. This restrains the newly registered broker-dealer from overextending itself by limiting by almost half the amount of indebtedness the firm's capital can support. Moreover, the broker or dealer who files an application for registration with the Commission must file with the application:

1. a representation that the capital of such broker or dealer has been contributed, and that such amount of capital will continue to be devoted to his business as a broker or dealer, and a description of the nature and source of such capital, and

2. a representation that adequate arrangements have been made by such broker or dealer for the establishment and maintenance of adequate facilities and the financing required for the carrying on of his business as a broker or dealer, and an undertaking that such broker or dealer will continue to maintain facilities and financing adequate for his business, and a detailed statement thereof, including a discussion of the nature of such arrangements with respect to:

   a. personnel,

   b. physical facilities,

   c. the maintenance and preservation of books and records as required by applicable provisions of law and any applicable rules of any national securities exchange or national securities association of which such broker or dealer is a member, including information concerning any arrangements made for the adequate performance of these functions and duties with a bookkeeping service company, or data processing service company, or otherwise, and

   d. the methods and procedures to be employed by such broker or dealer for the purpose of supervising the activities of persons associated with him, and

3. a statement describing the arrangements made for the obtaining of the funds required for the operation of his business for the first year of operations, and the uses to which such funds will be put, stating in appropriate detail the expenses expected to be incurred for such first year of operations; and setting forth the arrangements made, if any, for the obtaining of additional funds if such funds should become necessary.

In addition to these requirements, the Securities Exchange Act requires that, within six months following registration, the Commission must make an inspection of the firm to determine whether the firm is operating in accordance with the provisions of the Act and the rules thereunder. This would include an inspection of its facilities to ascertain whether the firm has personnel and records sufficient to comply with the rules.

Question #4: "To what extent are brokerage houses shifting losses or debits to overseas subsidiaries? How would such transfers affect their net capital requirements?"

Answer: At the outset, it should be noted that many large broker-dealers are subsidiaries of holding companies. It is generally the holding company, rather than the broker-dealer which may have overseas subsidiaries and not the broker-dealer itself. As a general matter, the holding company is not subject, unless also a broker-dealer, to substantive regulation by the Commission.

If a broker or dealer did shift losses or debits to its parent's overseas subsidiaries, its net capital requirement may be lowered, so long as the broker or dealer does not guarantee, endorse or assume directly or indirectly the obligations or liabilities of the subsidiary or affiliate.

The Commission has no knowledge of brokerage houses shifting losses or debits to overseas subsidiaries.

Question #5: "Are 'contingent liabilities' counted for the net capital requirements?

"If a brokerage house reported contingent liabilities of approximately $80 million as of October 31, 1979, and double that amount three months later, what would that suggest?"

Answer: The term "contingent liability" normally refers to a possible liability of presently determinable or indeterminable amount which arises from past circumstances or actions and may or may not become a legal obligation in the future. The uncertainty as to whether there will be any legal obligation differentiates the contingent liability from an actual liability.

The existence of contingent liabilities and, so far as possible, their amounts are normally disclosed. The most common method is to show contingent liabilities as footnotes to the balance sheet, rather than including them on the balance sheet. Only when a contingent liability is a near certainty as to obligation and amount will it be included in total liabilities on the balance sheet of the firm. The determination of whether to "book" the contingent liabilities is made according to GAAP and involves an assessment of the likelihood of the payment being required. Frequently, opinion of counsel may be required as to the validity of a claim. If an exact amount cannot be determined, the firm may set up an accounting reserve to anticipate potential losses. If there is no basis for a reasonable estimate, only the facts may be disclosed by footnote.

To compute net capital, a firm first starts with net worth calculated according to GAAP. From net worth, certain exclusions and deductions of assets not readily convertible into cash are made to reach net capital. If it appears that a contingent liability will become an actual liability, it is deducted in figuring net worth, which will reduce a firm's net capital. However, since most contingent liabilities are indeed contingent they are merely footnoted, and they would not be deducted from net worth and therefore would not lower net capital.

In determining how much minimum net capital a firm requires, however, contingent liabilities will be considered in many cases, since many firms calculate their capital requirements on the "aggregate indebtedness" method described above, which prohibits a firm from incurring "aggregate indebtedness" in excess of 1500% of the firm's net capital. Contingent liabilities are part of aggregate indebtedness whether or not they are deducted from net worth according to GAAP. To this extent, they impact net capital requirements. Firms using the "alternative" net capital rule, which sets requirements based on another measure (not liabilities) would not have their requirements raised or lowered. Most larger firms operate under the alternative.

However, under the alternative, the broker or dealer must include in the debit items (and therefore have net capital at least equal to 4% of) letters of credit collateralized by customer securities. Moreover, under the Commission's customer protection rule (17 C.F.R. 240.15c3-3), if a broker-dealer has a contingent liability in the form of a letter of credit on deposit with the Options Clearing Corporation, the amount must be figured into and reserved for under the broker-dealer's "Reserved Bank Account" calculation.

With respect to a firm with dramatically increasing contingent liabilities, nothing specific can be determined by that fact alone. Contingent liabilities include those arising from lawsuits, product guarantees, the cosigning of notes or letters of credit. Letters of credit may be issued on behalf of a broker or dealer for many reasons, including the need to make deposits with clearing organizations.

Question #6: "Lehman Bros. Kuhn Loeb and Merrill Lynch are two brokerage firms which have subsidiaries to deal in GNMA and Freddie Mac securities and Paine Webber was reported to be forming a similar subsidiary.

"Is one reason for the creation of these subsidiaries because 'money owed by customers affects the capital position' of the firm and therefore the net capital requirement?

"Does the SEC support the formation of these kinds of subsidiaries?

"Are any investor protections besides the net capital requirement avoided by the creation of this kind of subsidiary?"

Answer: At the outset, it should be noted that Merrill Lynch, the broker-dealer, is a subsidiary of a holding company. The holding company has an additional subsidiary which deals solely in government securities. Lehman Bros. Kuhn Loeb is a broker-dealer whose second-tier subsidiary deals solely in government securities.

The reason firms can and do form subsidiaries for transactions in GNMA and Freddie Mac securities is that these securities are so-called "exempt securities" as defined in Section 3(a)(12) of the Act. A broker or dealer who transacts business solely in exempt securities is free of the Commission's registration, financial responsibility and reporting requirements. While the Commission can regulate transactions in these securities by registered brokers and dealers, it has only antifraud authority over such exempted subsidiaries, whose liabilities are not guaranteed, endorsed or assumed by the broker or dealer. It should be noted, however, that if a broker-dealer guarantees, assumes or endorses the obligations or liabilities of the subsidiary, it must consolidate in a single computation the subsidiary assets and liabilities. Hence these liabilities will be reflected in the broker's or dealer's net capital requirements.

The Commission does not support the formation of these subsidiaries if done to evade the regulatory scheme of the Securities Exchange Act. In addition to the net capital rule, the creation of the exempt subsidiary avoids the so-called customer protection rule, Rule 15c3-3, which is designed to protect customer funds and securities in the possession of the broker or dealer. It also eliminates the various record-keeping, disclosure and filing requirements under the Securities Exchange Act.

Question #7: "Are there any restrictions on the amount of contingent liabilities (such as trading for their own account, underwriting, bank guarantees or letters of credit used in lieu of margin deposits) a brokerage house or dealer may undertake in relation to capital assets?" 1/

Answer: As discussed above, there are two bases for calculating capital requirements. Under the "aggregate indebtedness" standard, a firm is prohibited from incurring aggregate indebtedness in excess of 1500 per centum of net capital as those terms are defined. All contingent liabilities are considered in computing a firm's aggregate indebtedness, and therefore added to a firm's capital requirement. In other words, the more contingent liabilities a firm has, the more capital it needs to support that aggregate indebtedness.

Under the alternative net capital requirements, which are based on the amount of money owed a firm by customers, contingent liabilities are not considered in computing the firm's capital requirement, although as noted above, other rules may provide appropriate restraints.

In both circumstances, contingent liabilities normally are footnoted on the balance sheet and do not reduce net capital except when they must be deducted from net worth on the firm's balance sheet in accordance with GAAP, or an accounting reserve is established to anticipate potential losses.

Question #8: "What contingent liabilities must be disclosed by audits or in reports required by the Securities Exchange Act?

"What contingent liabilities should be disclosed to provide the public and brokerage customers enough information to assess the financial integrity of the firm?"

Answer: The Commission's reporting requirements (17 C.F.R. 240.17a-5) provide for an annual audit of virtually all brokers and dealers. This audit must be conducted according to GAAP with certain additional requirements. Under GAAP, virtually all contingent liabilities must be reported,

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1/ Trading by a broker or dealer for its own account in securities and underwriting securities are treated specifically under the net capital rule. Securities owned by the broker or dealer are required to be "haircut," that is, a prescribed amount of the value of the security is deducted from net worth. A firm commitment underwriting of securities is treated as if the broker or dealer owns the securities and the broker or dealer accordingly is required to haircut the contemplated position. See Rule 15c3-1(c)(2)(viii).

although these liabilities are normally only footnoted rather than actually deducted from net worth on the balance sheet. In general, it may be said that the Commission is satisfied that those contingent liabilities disclosed on the balance sheet according to GAAP are adequate to assist the public in assessing the financial integrity of a firm. The Commission has authority under Section 17(a) of the Securities Exchange Act to require additional disclosure should the need arise.

* * * * *

I hope these answers to your questions will assist the Subcommittee in its deliberations. If I can be of any further assistance to you, please do not hesitate to contact me.

Sincerely,

Harold M. Williams
Chairman

Mr. ROSENTHAL. The subcommittee stands adjourned until 10 a.m. tomorrow morning.

[Whereupon, at 11:20 a.m., the subcommittee adjourned, to reconvene at 10 a.m., Tuesday, April 15, 1980.]

SILVER PRICES AND THE ADEQUACY OF FEDERAL ACTIONS IN THE MARKETPLACE, 1979–80

80

TUESDAY, APRIL 15, 1980

House of Representatives,
Commerce, Consumer,
and Monetary Affairs Subcommittee
of the Committee on Government Operations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2247, Rayburn House Office Building, Hon. Benjamin S. Rosenthal (chairman of the subcommittee) presiding.

Present: Representatives Benjamin S. Rosenthal, Lyle Williams, and Jim Jeffries.

Also present: Peter S. Barash, staff director; Barbara Timmer, counsel; Eleanor M. Vanyo, secretary; and Jack Shaw, minority professional staff, Committee on Government Operations.

Mr. **Rosenthal.** The subcommittee will be in order.

We continue today hearings on the Federal response to the collapse of the silver market and the impact of that event on the financial markets. The subcommittee will receive testimony from the Chairman and Commissioners of the Commodity Futures Trading Commission.

We have asked the Commissioners to provide information in three general areas; first, an update on the traders, exchanges, and commodities most affected by March silver trading; second, the structural reforms proposed by the GAO in May 1978, including the concept of vertical integration of regulatory authority; and third, the possible effects on the various financial markets of either a corner on an underlying commodity or manipulation of a particular futures contract.

In addition, the subcommittee is concerned about the regulatory disparities among the Federal agencies regulating these markets, particularly in the broad area of customer protection, pyramid and tax-induced trading—conversion, deferral, and straddles—margin requirements, and the explosive growth in nonagricultural contracts.

What I thought we would do, Mr. Stone, is have you go first and then your colleagues will speak to the same issues. I understand there are some statements that ought to be either read or put into the record.

So, if you deal with those issues, that I'm told you are prepared to, we would be very grateful.

STATEMENT OF JAMES M. STONE, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION; ACCOMPANIED BY READ P. DUNN, ROBERT L. MARTIN, AND DAVID G. GARTNER, COMMISSIONERS

Mr. STONE. I am prepared to answer any questions the subcommittee may have of me this morning. I have not prepared an opening statement.

I would be able, if you would like, to provide some opening remarks without the benefit of a formal statement on some of the lessons that I think have been learned in recent weeks.

Mr. ROSENTHAL. Please.

Mr. STONE. In my view, the extraordinary rise in silver prices and the extraordinary price decline that we have recently witnessed, severely strained the functioning of futures markets and, in the process, called attention to the interrelationship between these markets and other financial institutions.

In that process, a number of strengths and weaknesses in regulation have been disclosed and I hope we have all learned from it.

We had a close call, but catastrophe has been avoided. There is no evidence at this point that any futures exchanges, clearinghouses, or the major futures commissions merchants, are in serious financial difficulty as a result of what happened.

The principal victims appear to have been the large speculators who attempted to make money on the price of silver.

Nevertheless, I do not think we should ignore the lessons of recent weeks. What happened raised the possiblity of a chain reaction in the financial community that would have been disastrous.

In my view, it should cause us to think about some important changes in regulatory approaches. I am certainly convinced that it is incumbent upon Government to prevent any one person or any group of persons from exercising such a tremendous degree of influence over a futures market.

As I have said previously before this subcommittee, I do not think speculative limits were an ideal tool once the cat was out of the bag, but I think speculative limits in advance are a sound concept. I hope the Commission will adopt speculative limits some time in the near future.

I think that with respect to the amount of speculation in the markets, however, position limits are not enough. In my view, we have to be taking a very serious look at margins.

I believe that the incentive to use the futures markets as a low downpayment acquisition vehicle, for someone wishing to hoard physical silver, was enhanced by the presence of low margins and that the danger of excessive speculation in general is increased as margins remain as low as they are.

Further, and perhaps even more important than the danger that we faced several weeks ago, I think some serious questions have to be asked about lending institutions making loans for margin purposes.

Those are, in general, forbidden with respect to securities and not with respect to commodities.

There are lessons to be learned about coordination between the agencies. Although there have been many fruitful discussions between the agencies over the last several years, and specifically on this subject recently, I think there is not enough coordination in general between agencies. I have no doubt that some of the issues that turned out to be important in this case fell between the cracks.

For example, I think the issue of institutional lending to meet commodities margin calls, both on the part of banks and on the part of brokerage firms in the stock business, didn't clearly fall with anyone's jurisdiction. Somehow it is incumbent upon Government to fill in any cracks that may exist and provide better coordination than has existed in the past.

In summary, I think those are among the lessons that ought to have been learned from all of this. We have to take a very serious look at position limits, margins, borrowing to meet margins, and coordination between the agencies.

And I hope that out of a close call, rather than a catastrophe, some good can come through better regulations.

With respect to your specific questions, I have very little to add unless you have something in particular to ask about. Our chief economist and our——

Mr. ROSENTHAL. Did you read the testimony yesterday of the Chairman of the Securities and Exchange Commission? He had some thoughts and observations.

Mr. STONE. I did not have a chance to read it.

Mr. ROSENTHAL. One of the things they talked about was suitability requirements, that brokers currently make sure that a stock transaction is suited to a customer's financial conditions and investment goals, but there are no similar requirements for commodities trading.

How about some tailoring in that area?

Mr. STONE. In none of the remarks that I have made in the past few minutes do I purport to represent the full Commission. You have the other Commissioners here. You'll be able to ask them.

Mr. ROSENTHAL. I'm asking you your own personal view.

Mr. STONE. Yes. And on that subject there has been much discussion within the Commission.

I favor suitability requirements in futures. I think that it is quite important for FCM's to take responsibility for the kind of client they induce into futures markets.

Mr. ROSENTHAL. What I'd like to know, and I think we asked you this earlier on, the CFTC was originally set up to deal with and regulate agricultural commodities.

How has it evolved since its origins to deal with other commodities and what share of your activities involve, for example, precious metals, and ongoing nonagricultural commodities.

Mr. STONE. I'm not sure it would be accurate to say that the CFTC was set up to deal with agricultural commodities. In fact, I think part of the reason the CFTC was created, was the recognition that other commodity futures were being traded.

Prior to that, our predecessor agency——

Mr. ROSENTHAL. Do you have any recollections of that statement in the legislative record?

Mr. STONE. I'm quite certain that it was discussed at that time. The Commodity Exchange Authority had been within the Department of Agriculture.

Mr. **Rosenthal.** What?

Mr. **Stone.** The Commodity Exchange Authority had been within the Department of Agriculture.

Mr. **Rosenthal.** And, the fact is that it interests me that your three colleagues all have agricultural backgrounds or at least have dealt principally with agricultural issues, if I read the biographies correctly. I may be misreading them.

Mr. Dunn was for 11 years with the Director of the International Institute for Cotton in Brussels, and had been associated with the National Cotton Council. Mr. Martin had a long experience in every phase of the marketing of grain and Mr. Gartner had been the legislative assistant for agriculture for Senator Humphrey.

So, that, the appointing authorities presumbly felt an agricultural background of experience was relevant to this assignment.

Mr. **Stone.** There's no question that the tradition of the agency, inherited from the CEA, largely focused around agriculture and I believe that I am the first Commissioner to have served on the CFTC who came from a background principally in finance.

Mr. **Rosenthal.** Taking into account what I just said, can you direct your remarks to the character of the nonagricultural commodities that are dealt with by the CFTC?

Mr. **Stone.** With respect to your question about the shares, I think it is true that the majority of the volume in futures markets today is still in the agricultural commodities.

A majority of the open interest, however, is in nonagricultural commodities, in metals and in financial instruments. The balance is fairly close to even. I don't think that with respect to open interest of volume or any other measure that there is a two-third, one-third weighting in either direction.

At least one-third, by any measure you would use, of what we are dealing with, is in nonagricultural commodities.

Mr. **Rosenthal.** And your testimony is still the same as it was at the previous hearing where you said:

> I do feel that the important point to understand is that when our act and this Commission were first put together, we were talking principally about domestic agricultural commodities.

Mr. **Stone.** Yes, I do believe that.

I believe that, and I think that the nonagricultural commodities have raised some of the kinds of difficult issues that we're talking about today.

I'm quite concerned about the deviation from textbook examples of futures markets that we now see in the real marketplace. In a textbook on how futures markets are supposed to work, you would learn that most of the activity, presumably, should be commercial and there should be enough speculation to support that commercial activity. And in some of our agricultural markets, that's still the case. You would find that in the case of the Minneapolis wheat market or the Kansas City wheat market which support massive commercial industries, that you'd have about 85 percent commercial activity and about 15 percent speculation which provides some liquidity in those markets.

Now, there are some agricultural markets in which the balance begins to tip the other way. But in most of the nonagricultural markets we regulate, the balance tips the other way, until you get to a situation like the silver market, in which the balance is reversed. At least 80 percent of the open interest, at least by one calculation, is speculative, rather than commercial. So, new questions and difficult questions are raised there.

Mr. ROSENTHAL. My question may not be artfully formed, but do you think, taking into account the experience of the Commission in dealing with agricultural commodities, they are equipped as a unit to deal with nonagricultural contracts, like silver?

Are there any inhibitions on the Commission's ability to deal in these other items?

Mr. STONE. I don't think there's anything structural that would prevent the Commission from dealing rationally with problems in nonagricultural futures markets.

It takes time, however, for the expertise of any Government agency to change and in this case what we've seen is a rapid explosion in the volume of nonagricultural futures trading.

And, to some extent it may be true that traditions and skills lag behind. It will take some time for there to be mastery in that area equal to that which is called for by the volume of those nonagricultural commodities.

Mr. ROSENTHAL. There are one or two other points, and then I want to give your colleagues an opportunity to respond too.

Mr. Williams made some other points. To limit the number of future contracts any one investor or any group of investors can purchase, what source do you have on that?

Mr. STONE. I said in my brief opening remarks that I support the concept of position limits. I think that's what he's talking about there. I would emphasize only that under our statute, as I think I stated last time, position limits can only be applied prospectively, that is, before the cat is out of the bag and positions had been taken.

And, therefore, I hope that the Commission will implement position limits of the sort that you're now talking about before we see another situation similar to the one we saw, recently.

Mr. ROSENTHAL. What thoughts do you have on margin requirements conceivably established by the Federal Reserve Board?

Mr. STONE. On the subject of margin requirements, I'm sure that you will find division within the Commission. My personal view is that there ought to be Government authority over margin requirements. I think there is clearly a public interest involved in the setting of margins. There is clearly a public interest involved in the determination of how much credit goes to finance commodity purchases. And, with respect to speculative margins—the margins that would be charged to people who were in these markets as speculators—I think the case can be made quite strongly in those markets that are tilted toward speculation that margins should be higher.

I would note that I am by no means the first person to say anything along these lines. President Roosevelt asked for margin authority in 1934. President Truman asked for it in 1947 when the CFTC was created. It was debated on the floor of the House and Congressman Vanik proposed a margin authority amendment to the CFTC Act, and he presented a well-reasoned argument as to why it should be passed.

In general, I think I agree with the positions taken by President Roosevelt and President Truman and Congressman Vanik. The Government should have some authority over commodities margin.

Mr. ROSENTHAL. Prior to 1975, the CFTC was a part of the Department of Agriculture.

Mr. STONE. Its predecessor agency, the Commodity Exchange Authority, was.

Mr. ROSENTHAL. It was part of the Department of Agriculture?

Mr. STONE. Yes, sir.

Mr. ROSENTHAL. Do you have any thoughts of whether the Commission should now be moved to partly under the wing or aegis of some other Government agency, maybe Treasury, the Federal Reserve, maybe SEC, maybe anything, I don't know.

Do you have any thoughts on the subject?

Mr. STONE. I'm certainly not convinced at this point that anything would be gained by doing that. There is clearly an advantage in a regulatory body to being an independent agency. Independence provides some continuity that being part of a cabinet office does not.

But, on the other hand, I guess one could argue that being part of a cabinet office permits exactly the opposite of continuity, a quick change in policy when the voters speak and elect a new Chief Executive.

Mr. ROSENTHAL. Has the Commission accepted——

Mr. STONE. But, I think I could not support a change right now.

Mr. ROSENTHAL. Has the Commission accepted gracefully as it were the intervention or involvement of other Federal agencies such as the Department of Treasury?

Mr. STONE. I think in general the answer to that is "Yes." There has been a great deal of contact between the Commission and these other agencies at the staff level. That's a point that didn't come out very well last time I was testifying here. Commissioner Dunn has chaired for some period of time now, on our behalf, a liaison between the agencies at the Commissioner level.

I think it has been quite useful and quite productive. I don't think, however, as I said in my opening remarks, that all of the questions that might fall between the cracks have been addressed.

Mr. ROSENTHAL. Mr. Dunn, do you want to read on behalf of your colleagues—I see your name is first on the statement.

Do you want to read this statement on behalf of your colleagues or how do you want to deal with it?

Mr. DUNN. Mr. Chairman, I would like to make a general statement if it's all right with you, to pass over that and have one of my colleagues comment on that.

Mr. ROSENTHAL. Please.

Mr. DUNN. I, like you and many others, have been quite concerned about what has happened in the silver market in the last few months. Certainly a runup in price from $4 or $5 to $50 in a short period of time, and a fall down to $10 has sent shockwaves throughout the entire economy.

I have been concerned and still am, also, about the comments about the situation which I have read in the newspapers and some of the questions which I've heard that have come from the Congressmen, because I feel that the problem is much more complicated than has been indicated by the press comments and some of the questions.

I think that it is absolutely necessary that all of us try to understand what happened and why it happened, and see what harm was caused. Then we should do what we can to improve the regulations, or to improve the controls of the institutions so that a new harm cannot be repeated.

Certainly we must protect the institution. We must protect innocent people from being unduly harmed.

I think, Mr. Rosenthal, it must first be recognized that the roots of this problem lie deep into the cash market and that these roots literally go to the four corners of the globe.

In my view, the cash market was rising because of the changes in the supply and demand situation. This cash market was pushing the futures market.

To be a bit more specific on what I mean, the production of silver through mining had been running short of the annual industrial consumption of silver, for a number of years.

The deficit has been made up by the melting down of coins, scrap and even old silver. Most people who follow the situation closely were aware that the general cash market was getting tighter and tighter.

The coin supply, which had been one of the principal sources meeting the deficit was getting smaller and smaller. Scrap was not increasing. And, for a long time there was not much indication that old silver was coming out of the woodwork, out of the attics and so forth.

And so, you had a tight situation developing in silver. Then the world inflationary forces began building up. People began to be, let's say, fearful of holding currencies, and began looking for something as a store of value that they could hold which, let's say, would stand the vicissitudes better than other things, particularly in money.

And, among those people that were looking for some better security, were not only people in this country who had great wealth, but people around the world. People in the OPEC countries who had large amounts of currency acquired, by reason of the runup in oil prices, because of the devaluation of these currencies and were looking for a place to put other funds.

People in the Far East, even banks, Mr. Rosenthal, all over were increasingly putting their funds into a store of value, precious metals, gold, and silver.

The positions on the futures markets were increasing, but in point of fact, some of the individual positions of people in this country that we read about in the newspaper were really not much larger than they had been in some previous years.

But other people by the same name also acquired positions, but even if the market participants had been only those individuals, the effect would certainly not have been the same.

It was the aggregation of people all the way around the world in the silver market, in taking silver out of the commercial supply and hoarding it.

Mr. ROSENTHAL. We've all read the stories in the paper about the Hunts and the 5 or 6 billion dollars' worth of silver they accumulated.

Doesn't that add another dimension to the problem where one or two people have a monopoly on the available commodity?

Mr. DUNN. It does indeed.

And my point is that that did result in a very large takeout from the commercial supply.

Mr. ROSENTHAL. If they take out from the commercial supply, it also involves other security markets and security brokers and a whole series of collateral events and one or two people can start the chain of events occurring.

Mr. DUNN. That's in the futures market, yes. But the point I am leading up to, Mr. Rosenthal, is that in my own opinion, the runup in the price of silver was caused primarily by the siphoning of cash silver out of the cash market by people all over the world.

And, I question whether the price of silver would have been much different had we closed the futures market.

Mr. ROSENTHAL. What share of it was people all over the world and what share of it was domestic and/or the Hunts?

Mr. DUNN. I don't have those data right in front of me, but we can supply those for the record.

Mr. ROSENTHAL. Take a guess.

Mr. DUNN. I'm glad you asked the question the way you did. Because, if you're talking about the cash market, nobody knows and that's the real problem, Mr. Chairman, that there is simply no information on cash holdings of silver around the world.

You ask five bankers in London, you ask five bankers in Switzerland and the answers you get on the silver that's in their country would differ by a billion dollars.

And, that problem is a real problem. How you deal with the cash silver markets of the world by regulation, I don't know.

Mr. ROSENTHAL. But do you see a distinct difference between the kinds of scenario you're talking about? And, what in fact happened when one or two people owned a majority of the available silver in the United States?

Mr. DUNN. I think it's very closely associated, Mr. Chairman.

Mr. ROSENTHAL. Was it?

Mr. DUNN. It's the ownership of the cash which is the genesis of the problem.

Mr. ROSENTHAL. The fact that they had the cash?

Mr. DUNN. The silver, the bullion, and coins. The physical silver is the genesis of the problem.

Mr. ROSENTHAL. Was there a time when the Commission became concerned about these things?

Mr. DUNN. Oh, yes, oh, yes.

We had been concerned about it, at least from last summer following.

Mr. ROSENTHAL. Did you ever do anything about it?

Mr. DUNN. We very closely watched the situation, tried to get the information on the holding. We were thwarted time after time in trying to get information as to who the foreigners were, and what they were doing and particularly on the holdings abroad. And even people in this country who began moving their silver out of this country so that it was beyond the reach of U.S. authorities.

Mr. ROSENTHAL. Is it your testimony, Mr. Dunn, that it was the foreigners that were causing the problem rather than the Hunts?

Mr. DUNN. I didn't say rather than. I said added together, Mr. Chairman.

Mr. ROSENTHAL. How would you equate their relative importance?

Mr. DUNN. Well, there were times when the foreigners were about as big as the local people.

We have an aggregation problem and aggregation is always hard to deal with. If you say everybody that has the same name ought to have his position aggregated, that's one thing, but that's more easily said than done.

So, the reason I don't give you a very specific answer is because I don't really know how to aggregate some of the accounts.

Mr. ROSENTHAL. The Commission became aware of a problem, the Hunts, in July, because the tape that we read of the July 27 meeting, was a discussion about the Hunts playing monopoly and things like that.

They were in fact engaged in a monopolization of the silver market.

Mr. DUNN. Certainly we were concerned about it as early as July. I have to go back and check the record. I daresay, we had been watching them and were beginning to be concerned even before that time.

Mr. ROSENTHAL. Did the Commission ever do anything?

Mr. DUNN. If you mean take specific action, no, we didn't.

We were in constant communication with the other agencies of Government. Mr. Stone, our Chairman, said that I had been serving as the liaison from the CFTC with the other agencies.

We had had—oh, I don't know how many dozens of meetings earlier on the financial instruments.

Mr. ROSENTHAL. But the record reveals that from the time you first became aware of some uncomfortable events occurring in the silver market, the Commission as a body never in fact did anything.

Mr. DUNN. No, we did not actually act. We had discussed a number of actions including position limits.

Mr. ROSENTHAL. You tend to embellish your answer. You did not act, period.

Mr. DUNN. We did not act.

Mr. ROSENTHAL. We know you discussed it. We know you talked about these things.

Mr. DUNN. And, with the other agencies, my records show that I had over 36 conversations myself with representatives of the other agencies, primarily the Treasury and the Federal Reserve from September through January, including numerous meetings.

Mr. ROSENTHAL. In most future contracts, such as silver, there's no delivery, is there?

Mr. DUNN. Oh, yes, delivery is a requirement of all contracts. It is the only means of bringing the futures and the cash together.

Mr. ROSENTHAL. What percentage is required for delivery of the contract?

Mr. Dunn. There is no required percentage and delivery varies. It's true that the deliveries in the silver futures were much higher than in most other contracts.

Mr. Rosenthal. What is the average percentage of delivery, about 5 percent?

Mr. Dunn. Well, we use a figure of 5 percent as being an indication of the percentage of commodities that are generally delivered on all contracts.

Now, it varies, contract by contract. It varies month to month. Sometimes it's lower than that and sometimes it's higher than that. But it was unusually high in silver. That is one of the problems that concerns me the most.

Mr. Rosenthal. Was the manipulation of the silver prices by virtue of delivery or nondelivery?

Mr. Dunn. Now you are getting to a hard question.

Mr. Rosenthal, you ask was it manipulation? The classic concept of manipulation is a distortion of the future against the cash, and that did not occur here. The cash silver prices in the United States and in London through this entire time were almost identical with the futures.

There's always a margin for the delivery cost, but they tracked together very, very closely. You rarely see cash and future prices through periods of time tracking any closer than these prices did.

There certainly was no distortion of the future against the cash.

Mr. Rosenthal. Have you discussed the matter with the Hunts?

Mr. Dunn. Yes, I have discussed the matter. When they came to the CFTC my colleagues and I have visited with them.

Mr. Rosenthal. Have you kept records of those visits?

Mr. Dunn. Yes.

Mr. Rosenthal. Your personal records or Commission records?

Mr. Dunn. I made notes or some of those attending the meeting made notes of the meeting and they're in the Commission files which, of course, are available to you.

Mr. Rosenthal. Would you provide those or shall we subpena them?

Mr. Dunn. I'll be glad to. I do not consider this as section 8 information because we didn't get into their individual positions and I'll be glad to.

Mr. Rosenthal. Thank you very much.

We will go by the order on the statement. Mr. Martin, your name is next.

Mr. Dunn. Could I make one quick comment, Mr. Rosenthal, on the points that I think need to be better understood for us to find solutions to these problems?

Some people seem to have the idea that somehow the CFTC should have prevented the price of silver from going as high as it did and again prevented it from going as low as it did, presumably by fixing a top or a level on these prices, the top and the bottom.

Mr. Rosenthal. It also happens to prevent people from cornering the market.

Mr. Dunn. Well, all right. But that's by action in the futures market.

On fixing the price: When the organization was created and we were first being confirmed in the Senate Agriculture Committee, I remember very well Senator Curtis going around the room and asking each one of us as nominees individually, "Do you understand that this act does not give you the authority to fix farm prices?"

"Yes, sir, until we understand this," neither does it give us the authority to fix nonfarm prices, whether they're on the futures market or not.

Mr. **Rosenthal**. Do you think there is any need for additional legislative authority to be given to the Commission?

Mr. **Dunn**. At this time I do not, Mr. Chairman.

Mr. **Rosenthal**. Do you have any regrets about any events that have taken place in the last month whereby the Commission might have acted and they didn't?

Mr. **Dunn**. I'm inclined to agree with Chairman Stone, that had we moved early enough on limits, limiting positions, we might have avoided, let us say, the appearance of this runup in prices being caused by the futures.

My problem with position limits has not been the concept of limiting concentration. It has been how you do it and most particularly how you enforce it.

The enforceability of position limits on people who are 10,000 miles away, that operate, let us say, through many different accounts and many different names is a very real problem.

Mr. **Rosenthal**. How many times in all have you met with the Hunts?

Mr. **Dunn**. I believe they have come to the office and I have been a party to their meetings on three occasions.

Mr. **Rosenthal**. Were all the members of the Commission present?

Mr. **Dunn**. No. But there were always other staff people present and I think every time a member of the general counsel, the executive directors staff or the surveillance staff.

I'd be glad to supply you with those memorandums.

[The material follows:]

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 2544318

April 15, 1980

Honorable Benjamin S. Rosenthal
Chairman, Subcommittee on
Commerce, Consumer and
Monetary Affairs
U. S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed, as per your request, are memoranda by members of the Commodity Futures Trading Commission staff of the meetings with the Hunts which I have attended.

My only written communication with them was a letter dated December 20, 1979, acknowledging receipt of an article. Please notice that, in this letter, I stated that I thought it would be necessary to reevaluate the economic purpose of the silver futures market if it continued to be used as a substitute for the cash market.

You also asked about contacts with the Department of Treasury, the Federal Reserve Board and the Securities and Exchange Commission. I am enclosing copies of memoranda summarizing my meetings and discussions with these agencies from August 1978 to the present as the CFTC liaison. More detailed memoranda to the Commission on the recent discussions, which are referenced in the summaries, are available, if desired.

You asked whether CFTC had been responsive to the requests of the other agencies. The enclosed copy of my letter to Robert Mundheim, General Counsel of the Department of Treasury, dated July 27, 1979, expressing appreciation for the cooperation of the Department of Treasury and the Federal Reserve Board in connection with the applications for financial futures, indicates that numerous changes were made by CFTC as a result of the discussions and states that the contracts finally approved conform substantially to the specific recommendations of the Treasury and the Federal Reserve Board.

The SEC was not specifically involved in the financial instrument contracts. However, when the CFTC was considering applications for contracts on commodity options, I had numerous discussions with the SEC to learn as much as possible from their experience and to get their suggestions. The staff document on options, which the Commission considered, contained many of the SEC suggestions. Subsequently, the CFTC decided to postpone consideration of options for a year.

With regard to silver, no one from any of the other agencies ever requested that the CFTC take any action in the silver market. The closest anyone came to a request for action was Robert Carswell's suggestion that we consider a suspension in order to give Bache time to reorganize its financing. Otherwise, I am not aware of any specific requests to the Commission from these agencies.

Your interest in the subject is appreciated.

Sincerely,

READ P. DUNN, JR.
Commissioner

Enclosures

CONGRESS [illegible]
STAFF
16
PARA:
COMMENTS:
FILE CODE:

Dunn

COMMODITY FUTURES TRADING COMMISSION
2033 K STREET, N.W., WASHINGTON, D.C. 20581

OFFICE OF
THE EXECUTIVE DIRECTOR

October 29, 1979

MEMORANDUM FOR: Files

FROM: Donald L. Tendick
Executive Director DLT

SUBJECT: Telephone Conversations Regarding Silver Futures Trading on the Chicago Board of Trade (CBT)

On Monday, October 22, 1979, at approximately 11 a.m., Blake Imel and I were in Commissioner Dunn's office discussing the Commission's scheduled agenda item on the desirability of establishing speculative limits in precious metals. A phone call was received by Commissioner Dunn from Mr. Robert W. Wilmouth, president of the CBT. Mr. Dunn asked me to also participate in the telephone conversation.

Mr. Wilmouth informed us that he had in the CBT's offices both Herbert Hunt and Nelson Bunker Hunt. Mr. Wilmouth indicated that they had asked the Hunts about their total futures positions and had been assured by both W. H. and Nelson Bunker Hunt that they had no undisclosed futures positions either in the United States or in any foreign trading company. Mr. Wilmouth then put Mr. W. H. Hunt on the phone. Mr. W. H. Hunt repeated that the Hunts did not have any undisclosed silver futures positions. He said the reports filed with the CFTC accurately and completely show their silver futures positions.

Mr. W. H. Hunt went on to review some of their recent cash transactions in silver. He reiterated the fact that they had a large exchange of futures for cash with Mocatta on which the CFTC had previously been notified. He also said that recently they had conducted a 5-million ounce EFP with Sharps, Pixley. The Hunts gave up their long futures positions and obtained cash silver bullion in London. He indicated this transaction took place approximately 2 weeks ago. He further informed us that they have traded 2 million ounces of silver bullion in New York for 2 million ounces of silver bullion in London. I believe he said that trade was also with Sharps, Pixley. One further transaction was conducted with J. Aron & Co. This trade involved the Hunts giving J. Aron & Co. 2 million ounces of silver bullion in Chicago in return for 2 million ounces of silver bullion in Zurich. All of the cash exchange transactions were completed by International Metals Corporation in Bermuda. The actual change of title will take place between October 22 and November 15, 1979.

At that point, Mr. Nelson Bunker Hunt came onto the phone and requested an opportunity to meet with Commissioner Dunn to discuss areas of mutual interest. Mr. Dunn agreed to see Nelson Bunker Hunt at 3 p.m. on Tuesday, October 23, 1979. John Mielke has prepared a memorandum to the files summarizing that conversation.

cc: Commissioner Dunn
Blake Imel
John Mielke

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W.
Washington, D.C. 20581

OCT 25 1979

MEMORANDUM

TO: The Files

FROM: John Mielke

SUBJECT: Meeting with Nelson Bunker Hunt

On the afternoon of Tuesday, October 23, 1979, a meeting with Mr. Nelson Bunker Hunt was held in Commissioner Dunn's office. In addition to Commissioner Dunn, CFTC was represented by Donald Tendick, Blake Imel and John Mielke.

Mr. Hunt explained that he and his brother, Herbert, had been requested by the Chicago Board of Trade to meet with exchange officials on the prior day. He said the exchange had questioned him about the Hunts' silver trading. Hunt maintained that he and his brother trade futures independently of one another.

Mr. Hunt said apparently most of the traders on the Chicago Board of Trade silver market are spreaders and that those traders were disturbed about the spread relationships that had occurred in the silver futures market. He commented, however, that he thought one of the biggest problems with the silver futures market right now was the high level of margins. Anyone who wanted to buy silver futures would have to pay an unusually large amount of money to acquire a single futures contract.

Mr. Hunt said he had long positions in the futures market because he has thought for a long time that the silver market was ready for a substantial upward price movement. This is principally due to the fact that for years the consumption of silver has exceeded production. Over the long term he expects the gold/silver ratio to decrease to about 5 to 1. This may not occur in the near future, but in several years it is not unrealistic, in his assessment.

Hunt said he could not understand why anyone would want to be short silver. He said he trades almost all markets from the long side. He very rarely establishes a short position except as part of a spread. Hunt and his brother own a substantial quantity of silver that they acquired 4 or 5 years ago. This silver is included in Chicago Board of Trade and Comex certificated silver stocks. He said it is located in the First National Bank of Chicago and the Citi-Bank and Chase Manhattan Bank in New York. He wished the silver that he owns was not included in certificated stocks because he believes that it is misleading to have it that way. He indicated that he has no intention of selling the silver. He once thought of moving it to a bank in Texas but found out that he would have to pay a sales tax if he did so.

Hunt said the Chicago Board of Trade wanted to know if he or his brother had additional positions that were not being reported. He said that all of his silver positions are reported to CFTC. These are the positions that he and his brother have in their own names plus their interest in International Metals Investment Company (IMIC).

Mr. Hunt said he did not want to do anything that would be detrimental to the futures market. He said the futures market has been good to him over the years. Therefore, he and his brother will try to avoid causing any problems. Hunt said that although he and his brother were unwilling to sell the silver bullion they owned because of tax considerations, they would be willing to swap certificated silver stocks for noncertificated silver. He cited as an example of the steps they were willing to take the EFP's for silver that they had arranged with Mocatta and others. In return for about 4,600 long futures contracts, IMIC acquired silver bullion, silver coins, forward contracts for silver, and silver in other forms from Mocatta. Hunt did not think anyone else could have made a deal like that with Mocatta. He said his brother, Herbert, worked out the details. None of the silver involved in the Mocatta EFP was certified stocks on either the Chicago Board of Trade or Comex.

The Hunts have also been exchanging vault receipts for silver in New York and Chicago for equal quantities of silver in London and Zurich. They have not shipped any silver out of the United States. He said by making these trades of physical silver they were saving others the cost of shipping silver to the United States. He also indicated, however, he tended to prefer silver located in Europe. He said he was afraid the U.S. government might expropriate silver from individuals as it did in the 1930's when individual citizens were no longer permitted to own gold.

IMIC was formed earlier this year as an offshore corporation. It is owned half by the Hunts and half by two individuals from Saudi Arabia. It was formed as a Bermuda corporation for tax reasons. IMIC has invested in silver, gold and platinum. It also has plans to invest in some other projects, such as an oil refinery and a copper mine. When told that it appeared that IMIC's investment strategy with respect to silver was to acquire the physical commodity, Hunt did not disagree. When asked what CFTC might expect from IMIC in the future, he said that unless the silver market breaks in price it is not likely that they will add new long positions to acquire additional silver. He said the high interest rates of 16 percent make him think twice before he will purchase additional silver.

Hunt said the trading decisions of IMIC are made by the board of directors, of which he is a memeber. Hunt, his brother, and two others meet about once a month to discuss the IMIC investments. They also talk frequently over the telephone about IMIC's trading.

Hunt said he has only met one of the two Saudi Arabians who are involved in IMIC. He has met Ali Bin Mussallam on a number of occasions. He has not met Mohammed Aboud Al-Amoudi, but he believes his brother, Herbert, has met him at least once. These two Saudis travel around the world frequently. They often turn up in New York, Paris, and London.

Hunt said these are the only two Arabs that he knows are investing in the silver market. However, he has reason to believe that there are a number of other wealthy individuals who are acquiring silver. He based that statement on conversations with Arab individuals that he has met on his various trips to Europe. He said a number of individuals have asked him about the silver market and have indicated that they are also investing. He said the Arabs have been purchasing gold for the last 2 or 3 years, and he thinks recently they have moved into silver as well. Arabs, he explained, are afraid of paper assets. They are unwilling to invest in corporations because they don't trust the instrument of the stock certificate. They prefer to invest in real estate, gold and other tangible assets.

Hunt said that he was acquiring silver through the futures market because it was easier than obtaining large quantities in the cash market. Frequently bullion dealers would not even give a bid in the cash market. He said there is a cash and carry market in London, referring to the LME, but that is a very small market.

Hunt said that he expects to roll forward the long futures positions that he is carrying in his own name. This is how he has been trading the silver market for the last few years. Normally, he rolls his long position forward as that position approaches the spot month. He has held his long position in the March Comex future, however, for quite a few months. He is attempting to get a long term capital gain from that position. Consequently, he does not plan on rolling it forward unitil after the beginning of the year.

Commissioner Dunn thanked Mr. Hunt for coming to Washington to visit with CFTC. He said because of the volatile and rapid price run-up that has occurred in silver over the last two months, the Commission has been concerned with the market. Questions have been raised as to whether silver prices are reflecting a legitimate demand for silver or whether someone is forcing the price up artificially. He said the Commission had noted that the Hunt positions were large relative to the market, even larger than the positions the Hunts normally carry. Mr. Hunt acknowledged that perhaps they were larger. Commissioner Dunn commented that one of the alternatives the Commission was considering to deal with the silver market was the imposition of speculative position limits. Mr. Hunt commented that he hoped that no limits or artificial restraints would be imposed on the market, particularly not before the first of the year. He said he would incur a substantial tax on his position if he had to liquidate it before the new tax year.

MEMORANDUM

November 9, 1979

TO : John G. Gaine
Pat G. Nicolette

FROM: Mark N. Rae

RE : Meeting between Commissioner Dunn and William H. Hunt

On November 7, 1979, I attended a meeting between Commissioner Read Dunn and William Herbert Hunt. The meeting was held in Commissioner Dunn's office.

Mr. Hunt requested the meeting in order to present his side of the silver situation. Mr. Hunt believes that the emergency measures which the Chicago Board of Trade ("CBOT") and the Commodity Exchange ("Comex") have proposed are not "market-neutral".

The CBOT is considering the adoption of speculative limits. Any speculator with holdings in excess of those limits would be required to reduce his holdings by early February. Mr. Hunt's present holdings exceed the proposed limits. If he is forced to liquidate the excess in a short period of time, he will suffer a significant financial loss.

The Comex proposes higher margin requirements for existing positions over certain levels. Mr. Hunt maintains that adoption of this proposal would be unfair. The margin requirements for all positions should be the same.

Mr. Hunt questions whether a decision by either of these exchanges to take emergency action would be disinterested. He understands that certain members of these exchanges hold large short positions. Adoption of the speculative limits and margin requirements proposed would benefit these exchange members to the detriment of non-members like himself. He has made the exchanges aware of his concern in this regard.

Mr. Hunt stated that he has asked the Commission to hold prompt hearings on any actions which the exchanges might take in connection with silver. However, he understands that the Commission's preliminary response to this request was negative.

Mr. Hunt claims to have played no part in the rise in silver prices in the last few months. His holdings today are no larger than they were in August. Moreover, he maintains that the position which he presently occupies in the silver futures market is no larger than the position which he has held consistently since 1973. In fact, he contends that at various times during the last six years his holdings have been twice as large.

Mr. Hunt concedes that his holdings now represent a larger share of the open interest than they have in the past. However, he maintains that this has occurred through no fault of his own. The higher margin requirements which the exchanges require have cut the open interest in half.

At present, margin requirements are so high, they no longer make economic sense. Eighty percent financing can be obtained for the purchase of silver in the cash market. In contrast, the margin requirements for a silver futures contract represent almost 40 percent of the cash value of the contract.

Mr. Hunt believes that the price of silver accurately reflects current supply and demand conditions, and expectations about the future. Moreover, he predicts that the price will rise even higher. This prediction is based in part of the fact that consumption of silver exceeds refining capacity by over 200 million ounces annually.

However, Mr. Hunt maintains that silver is available in the cash market. Recently, Englehard Metals offered him 40 million ounces for delivery over several months at the then current price.

Mr. Hunt also offered a fascinating glimpse into an aspect of Henry Jarecki's operations. Mr. Hunt recently transferred certain long silver futures positions to Mr. Jarecki in exchange for silver and options on silver. The options were unusual. Apparently, the cash reserve which banks are required by law to maintain exceeds the amount necessary to conduct their day-to-day operations. Mr. Jarecki sells bags of silver coins to banks at the face value of the coins for use as cash reserves, subject to Mr. Jarecki's option to repurchase the coins at their face value. The bank is paid 1 or 2 percent of the face value of the coins for the option. Mr. Jarecki is able to use the option as collateral for financing based on the silver value of the coins.

Other matters were discussed at the meeting, but they were not relevant to matters presently before the Commission.

cc: John Mielke
Teresa Hermosillo

December 20, 1979

Mr. W. Herbert Hunt
2500 First National
  Bank Building
Dallas, Texas 75202

Dear Mr. Hunt:

Thank you for sending me a copy of the "Fortune" article on silver. I also received a copy of your comment on the Chicago Board of Trade proposals on position limits. We appreciate your views.

The silver market is receiving a great deal of press coverage these days and I expect there will be more. I am called every few days by reporters. I have consistently refused to comment on the discussions we had with you and Bunker Hunt or to discuss any individual's positions, and I will continue to refuse to answer such questions. Our staff has been instructed to do the same. I do not think the Commission has been the source of any information reported about your positions or those of any other person.

With regard to the general question, I must tell you again that I grow increasingly concerned about the conversion of the metals futures markets into markets for acquiring the physical commodities. I think the time has come to reconsider the economic purpose of these contracts. We did not intend, when we designated the contracts, that they would become a substitute for cash markets.

Sincerely,

READ P. DUNN, JR.
Commissioner

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W.
Washington, D.C. 20581

January 21, 1980

MEMORANDUM

TO: The Files

FROM: John Mielke JM

SUBJECT: Meeting with Mr. N. B. Hunt

At the request of Mr. N. B. Hunt, a meeting was held with Mr. Hunt at 3 p.m. on January 8, 1980, in the office of Commissioner Dunn. CFTC personnel present at the meeting were Commissioners Dunn and Martin, John Gaine, and John Mielke.

The meeting began with general discussions of the recent grain embargo, cotton farming, and a few other topics. Mr. Hunt then asked whether or not the CFTC had disapproved the emergency action taken by Comex on January 7, 1980, establishing speculative limits on silver. Mr. Hunt was told that the Commission had not "disapproved" that action. He was also told that CFTC would continue to watch the silver market very closely to determine whether any additional action might prove necessary.

Mr. Hunt asked whether CFTC's objective was to raise, lower, or stablilize silver prices. He was told that none of those was the case. Rather, the Commission was trying to insure that the silver futures market continued to be a viable market place reflecting the forces of supply and demand. The Commission was concerned with the increased use of the futures market as a source of supply for substantial quantities of silver bullion over the past few months.

Mr. Hunt also asked whether CFTC was considering action to shut down the silver market. He was told that the Commission has taken no such action to date.

Mr. Hunt was told that CFTC's surveillance staff continued to be concerned with the liquidation of the February 1980 CBT silver contract because there was no speculative limit in effect for that contract. Mr. Hunt responded that he and his brother had liquidated about 1,100 contracts in that future the prior day. He said Ralph Peters, as an individual trader, had telephoned him to ask if Hunt was interested in arranging an "EFP" (exchange of futures for product) transaction involving CBT February silver. Peters allegedly complained that he was having difficulties meeting margin calls on positions in the CBT February and Comex March 1979 silver contracts. Hunt said that there was no silver bullion involved in the EFP transaction.

Hunt stated that he intended to get out of his long positions in the CBT February and Comex March silver futures as best he could. He does not intend on taking substantial deliveries unless the spreads get out of line. He said he wanted to act in a legal and responsible manner. He said these long positions were old positions, some of which were still not quite six months old. He was concerned, however, that with the higher margins and other restrictions there would be no buyers in the market who could absorb the positions he had to sell.

cc: Commissioner Dunn
Commissioner Martin

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Robert L. Martin
Commissioner

(202) [illegible]

April 17, 1980

CONGRESSMAN BEN ROSENTHAL
RECEIVED
STAFF: ______ DOC #: ______
REC #: ______
APR 18 1980
PAGE: ______
COMMENTS: ______
FILE CODE: ______

Honorable Benjamin S. Rosenthal
Chairman, Subcommittee on Commerce,
  Consumer and Monetary Affairs
Committee on Government Operations
U. S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

In order to clarify the record I have enclosed a copy of the minutes of the Commission meeting held on January 8, 1980, that was discussed at your hearing on silver, Tuesday, April 15, 1980. The purpose of this Commission meeting was to permit representatives of the MidAmerica Commodity Exchange, the Chicago Board of Trade, and the Commodity Exchange, Inc. to brief the Commission on the silver markets and the remedial action being proposed by the Chicago Board of Trade and Commodity Exchange, Inc. (non-applicable information has been deleted from the minutes). Copies of the required Sunshine Act documents are also enclosed.

Sincerely,

Robert L Martin

Robert L. Martin

Enclosures

Commodity Futures Trading Commission Minutes

Tuesday, January 8, 1980 9:35 AM 8th floor conference room

Commissioners: Chairman James Stone, Commissioner Read Dunn, Commissioner Robert Martin, Commissioner David Gartner

Staff: John Manley, John Mielke, Don Tendick, Jack Gaine, James Culver, Jean Webb

The Commission voted unanimously to close the meeting and to hold the meeting on less than seven days notice.

CLOSED:

1. The Commission continued the discussion of January 6 regarding the suspension of the grain markets. It was agreed that the opening of the markets should not be delayed beyond Tuesday, January 8, 1980.

2. Silver

   The Commission was briefed by the staff on the current silver positions.

The Commission continued the meeting at 10:10 AM in the 5th floor hearing room

Commissioners: Chairman James Stone, Commissioner Read Dunn, Commissioner Robert Martin, Commissioner David Gartner

Staff: Jack Gaine, Pat Nicolette, John Mielke, John Manley, Don Tendick, James Culver, Jean Webb

Exchange Participants:

MidAmerica Commodity Exchange	Donald G. Nash Mark K. Bruscke David H. Morgan
Chicago Board of Trade	Robert K. Wilmouth John F. Gilmore John Stassen
Commodity Exchange, Inc.	Andrew F. Brimmer Lee Berendt John F. O'Neal David Rutledge Mark Buckstein

The representatives of the three exchanges briefed the Commission on the silver markets and the action being proposed by the Chicago Board of Trade and the Commodity Exchange.

CERTIFICATION

I, John G. Gaine, General Counsel of the Commodity Futures Trading Commission, hereby certify, pursuant to 5 U.S.C. 552b(f)(1), and pursuant to Section 147.5(g) of the Commission's Regulations Pertaining to Open Commission Meetings, 17 CFR Pt. 147, that, in my opinion, Commission deliberations concerning

CONTRACT MARKET SURVEILLANCE MATTERS

scheduled to occur on JANUARY 8, 1980 AT 10:00 A.M.

(and from time to time thereafter as the Commission may, pursuant to the provision in 17 CFR 147.5(c), find appropriate) may properly be closed to public observation.

The relevant exemptions on which this certification is based are set forth in the following provisions of law:

Subsection 552b(c) of Title 5 of the United States Code	Section 147.3 of Title 17 of the Code of Federal Regulations
5 USC. §§ 552b(c)(3) and (9)(A)(i)	17 C.F.R. §§ 147.3(b)(3) and 147.3(b)(9)(i)

John G. Gaine
JOHN G. GAINE
General Counsel

DATED: JANUARY 8, 1980

EXPLANATION OF DETERMINATION TO CLOSE THE
JANUARY 8, 1980, MEETING OF THE COMMISSION
ISSUED PURSUANT TO 17 C.F.R. §147.5(f)

The Commission, by unanimous vote, has determined that the meeting scheduled for January 8, 1980, shall not be open to public observation because the meeting, which will concern contract market surveillance matters, may involve matters specifically exempted from disclosure by Sections 8 or 16 of the Commodity Exchange Act, as amended, 7 U.S.C. §§12 and 20, and may disclose information the premature disclosure of which would lead to significant financial speculation in commodities.

Persons expected to attend are as follows: Chairman James Stone, Commissioner Read Dunn, Commissioner Robert Martin, Commissioner David Gartner. Staff: Don Tendick, Jack Gaine, John Mielke, John Manley, Jean Webb. Donald Nash, MidAmerica; Mark Bruecke, MidAmerica; David Morgan, MidAmerica; Robert Wilmouth, Chicago Board of Trade; John F. Gilmore, Chicago Board of Trade; Andrew Brimmer, Comex; Mark Buckstein, Comex; John O'Neal, Comex; John Stassen, Kirkland & Ellis representing CBOT; David Rutledge, Comex

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 254-6318

April 9, 1980

MEMORANDUM TO: Files

FROM: Read P. Dunn, Jr.

SUBJECT: Notes on Discussions with the Treasury Department and the Federal Reserve Board on Silver, September 1979 through March 1980

When a certain amount of congestion was observed in the silver futures market, I called the Treasury Department and the Federal Reserve Board in September 1979 to ascertain the nature and extent of their interest in the silver and gold markets, and to learn whether they monitored the futures or were particularly concerned about developments. At that time, I learned they considered silver as just another commodity and expected the prices would move up and down, as is the case with other commodities. They showed no particular interest in silver. They would be interested in gold only if there appeared to be a move by foreign central banks to remonetize currency. However, they recognized that strong upward movements could have psychological influences on prices generally and, for this reason, asked to be kept advised on developments. They saw some broad relationship of gold and silver prices with financial futures, which are also considered to be a measure of inflation and interest rate opinions. They planned to monitor financial futures, themselves, and wished to consult regularly with CFTC.

Following the International Monetary Conference at Belgrade, both the Treasury and the Federal Reserve Board became more interested in the precious metals but primarily in gold. I explained that we saw no problem in gold futures markets as there was no large concentration and the deliverable supply appeared ample. They still expressed no real concern about silver but asked to be kept advised.

During the course of the next three months, I initiated frequent telephone conversations with various officials of the two agencies to keep them advised on developments in silver and other metal markets. The conversations usually included discussions of financial futures as well, especially during December, because there was perceived to be some relationship. Whenever the question came up, I told them my personal view was that the basic cause of the run up in silver and gold prices was the heavy buying by speculators of the physical commodities as a hedge against inflation. I pointed out that the futures are essentially reflections of the cash market supply and demand. I told several people that I doubted whether higher margins would deter the big money people who were obviously interested in acquiring bullion or other forms of physical commodities and had the money to buy it. I stated to Anthony Solomon, of Treasury, and Gerald Corrigan, from Chairman Volcker's office at the Federal Reserve Board, that I was of the opinion that, in this situation, silver and gold prices would not likely be much lower if the futures markets were closed.

The only person from either agency who ever expressed concern about the silver market was Robert Carswell. of Treasury. This was on March 31st in his 10:30 p.m. call regarding Bache's request to close the silver markets. Mr. Carswell then thought a suspension, to permit the houses in trouble to arrange their financing, was advisable, but he did not press his point and asked simply that I think about it.

My memos on those meetings and conversations, most of which were circulated, are as follows:

1. Memorandum dated September 26, 1979, on 'Federal Agency Action to Silver and Gold Prices'.

2. Memorandum dated September 26, 1979, regarding a call to Peter Keir, of the Federal Reserve Board, about the futures markets in silver and gold.

3. Memorandum dated October 15, 1979, regarding telephone conversations with Gerald Corrigan and Peter Keir of the Federal Reserve Board, on the gold and silver markets.

4. Memorandum dated October 17, 1979, regarding a visit with Treasury's Anthony Solomon and Lyle Widman, Fred Struble of the Federal Reserve Board and John Mielke, to discuss the effect of futures market activity in gold and silver.

5. Memorandum dated October 26, 1979, regarding follow-up telephone conversations with Anthony Solomon, of Treasury, to discuss developments in the gold and silver markets.

6. Memorandum dated December 4, 1979, regarding meetings at the Federal Reserve Board with Governor Henry Wallich and Peter Keir.

7. Memorandum dated December 7, 1979, regarding a meeting with John Mielke and Gerald Corrigan, of the Federal Reserve Board, to discuss the gold and silver markets.

8. Memorandum dated March 31, 1980, regarding a call from Robert Carswell, of Treasury, to discuss closing the silver markets.

Attachments

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 254-6318

March 31, 1980

MEMORANDUM TO: Files

FROM: Read P. Dunn, Jr.

Late Thursday, March 27, John Conheeney of Merrill Lynch called back to say that after looking at the figures and talking with his associates he thought it would be wise for CFTC to direct the silver markets to be closed and the positions liquidated. I told him I had not seen evidence that forces of supply and demand could not be accurately reflected in the futures market and pointed out that such a finding was necessary for a declaration of an emergency. He did not argue my point.

About 10:30 p.m., Robert Carswell, Deputy Secretary of Treasury, called me to say the President and the Executive Vice President of the New York Stock Exchange had called and asked him to urge the CFTC to close the silver markets to allow time for Bache to arrange financing to avoid being closed by the New York Stock Exchange or SEC. I told him I doubted the wisdom of such a move but would think about it.

cc: Chairman Stone
Commissioner Martin
Commissioner Gartner
John G. Gaine
Donald L. Tendick
James Culver
John Manley
Jane Stuckey
John A. Field, III

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 254-6318

December 7, 1979

MEMORANDUM TO: Files

FROM: Read P. Dunn, Jr.

Gerald Corrigan, Special Assistant to Chairman Volcker of the Federal Reserve Board, met in my office today with me and John Mielke to discuss the gold and silver markets at the request of Chairman Volcker in preparation for the Chairman's monthly meeting in Basel, Switzerland, on monetary problems. We reviewed developments in both markets pointing out the concentration in silver and the lack of concentration in gold. We again expressed concern because of the large positions of a small group of speculators in the cash and futures markets in silver but indicated that we hoped the recent restrictions imposed by the exchanges would keep the situation under control. The FED continued to be primarily interested in gold as gold prices might affect the general price level and foreign exchange rates. I told them we were not particularly concerned about gold because there were no large concentrations in the futures markets and no apparent scarcity of gold bullion for delivery.

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 254-6318

December 4, 1979

MEMORANDUM TO: Files

FROM: Read P. Dunn, Jr.

SUBJECT: Meeting at Federal Reserve Board

I met with Peter Keir of the Federal Reserve Board on November 26 to discuss the FED study for the interagency committee. He said he had completed the editing and had returned the copy to the authors for final typing and reproduction. It should be distributed in a few days. Peter said the paper did not discuss stock index futures specifically. It does discuss the FED's margin authority, the objectives and the manner in which this authority has been implemented.

I also met Governor Henry Wallich and discussed the paper on financial futures he gave at the recent symposium at the Shoreham Hotel. He expressed interest in seeing futures on stock indexes tried. He said while the idea is revolutionary, the concept was interesting and such futures could provide needed protection for investors during periods of price uncertainty. He was not particularly concerned about the diversion of capital from equity markets and considered the capital would best be encouraged to the equity markets by making the equities more interesting. However, he did indicate there would doubtless be considerable discussion about margin levels for general reasons. He thought that an index on a broad average of stocks would be especially interesting for institutions that hold large portfolios. He said the FED had not officially considered the question of stock indexes yet.

cc: Chairman Stone
Commissioner Martin
Commissioner Gartner
John Gaine
Blake Imel
John Manley
Barbara Leventhal

P.S. A copy of the Federal Reserve Board's Report to the Inter-Agency Task Force is attached.

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 254-6318

October 26, 1979

MEMORANDUM TO: Files

FROM: Read P. Dunn, Jr.

SUBJECT: Follow-up Telephone Conversation with Anthony Solomon of Treasury Department

I had two telephone conversations with Anthony Solomon of Treasury Department on October 22 and 26, following our meeting of October 16, to discuss the developments in silver and gold markets. I called him on October 26th to advise him of the actions taken by the CBOT and Comex.

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 2546318

October 17,1979

MEMORANDUM

TO: Chairman James M. Stone
Commissioner David G. Gartner
Commissioner Robert L. Martin

FROM: Read P. Dunn, Jr.

SUBJ: Visit with Treasury.

On Tuesday afternoon John Mielke and I met with Mr. Anthony Solomon Under Secretary of the Treasury for Monetary Affairs, at his request, for the purpose of discussing the effect of futures market activity in gold and silver. Mr. Paul Volcker, Chairman of the Federal Reserve Board had also expressed concern about these markets and arranged for Mr. Fred Struble from the Board to attend the meeting. Mr. Volcker's office had relayed some questions addressed to Mr. Volcker by Senator Proxmire when he appeared before the Senate Banking and Currency Committee, Oct. 5, about gold and silver futures and had indicated Mr. Volcker should anticipate similar questions from the Joint Economic Committee when he meets that body October 17.

With Mr. Solomon at the meeting was Mr. ~~Leslie~~ Lyle Widman, Deputy Assistant Secretary for International Monetary Affairs, with whom I had previously discussed the gold and silver situation at the suggestion Mr. Robert Mundheim.

Mr. Solomon explained the Treasury's concern about inflation and the declining value of the dollar in international markets and described the Treasury's anti-inflation program. He mentioned the new policy on gold sales which was announced publicly last night and the Federal Reserve Board efforts to discourage bank loans for speculating in gold and silver and other commodities, which program was also announced later in the day.

Mr. Solomon told us some of the OPEC countries have indicated they calculate the value of oil in gold and convert that price into dollars and that on that basis oil is underpriced. This causes concern because of the threat of higher dollar prices for oil if gold prices stay high.

He also said concern was expressed generally at Budapest about currencies and commodities world wide and that many thought the high prices on gold and silver were stimulated by speculative buying. Swiss bankers had inferred that speculation was greater on US futures markets because margins were lower than in Switzerland.

Mr. Solomon then asked to do what we could to get margins raised on the US futures markets. His direct concern was gold prices but he recognized a close relationship with silver and some relation to other commodity prices.

We explained the statutory prohibition against CFTC setting margins. Mr. Solomon said he understood the statute prohibited CFTC directing such action but thought we might quietly talk with the Exchanges and encourage them to take the action themselves in the national interest.

I told him I would mention the Treasury's concern to the Exchanges involved but doubted they would act on the suggestion. We explained the difference in margins on futures and the margins charged by Swiss and other European banks on their forward sales and said they were not comparable. I pointed out that buyers on the futures market pay 100% of the price when they take delivery. I told him that I personally question whether margins are the most effective way to restrict activity in the gold and silver markets at this time.

He also asked why margins differ so widely in gold and silver and from Exchange to Exchange? We explained that the gold margins had apparently been kept relatively low because there was no large concentration of speculative positions on the long side and a heavy concentration of commercials with gold on the short side. Also we said gold had not experienced as erratic and volatile gyrations as silver. Further, gold appears to have followed the London and Zurich prices. While gold deliveries have been large recently, the level of certificated stocks has not changed significnatly indicating that the gold taken had mostly been retendered. In silver, by contrast, there were large speculative positions on the buy side many of which are foreign and large quantities of silver are being taken on delivery and shipped out of the country, thus tightening up the deliverable supply.

In summary, I told Mr. Solomon that the Commission shares the concern of the Treasury about the effect of spiraling prices of gold and silver and also the apprehension that at least some of this run up may be the result of excessive speculation and that the Commission at its morning meeting had asked the staff to consider the advisability of imposing quantitative restrictions on positions I added that several of us had expressed the view that it would be preferable if the Exchanges took restrictive actions voluntarily but that CFTC should consider the possibility of a directive.

In conclusion I explained that we will be studying the situation carefully, and we will especially try to determine how much of the price action results from the upward pressures in the cash market, and we will also try to evaluate the probable effect of any restrictive actions.

Mr. Solomon recognized, as we do, that part of the problem is undoubtedly psychological resulting from perceptions that may not be entirely accurate. However, he also made clear that governments have to deal with public perceptions.

Mr. Solomon indicated he would endeavor to talk to Mr. Andrew Brimmer and Mr. William Simon, who are on the Comex Board, to explain Treasury's concern.

We agreed to keep in touch.

Following the meeting Fred Struble obtained more factual information from John Mielke about the gold and silver markets for a memo to Mr. Volcker for use in his testimony before the Joint Economic Committee.

cc: Vernon Pherson
Don Tendick
John Gaine
John Manley

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 254-6318

October 15, 1979

MEMORANDUM TO: Files

FROM: Read F. Dunn, Jr.

Gerald Corrigan, Special Assistant to Chairman Volcker of the Federal Reserve Board, called today to ask for information on gold and silver markets requested by Chairman Volcker in preparation for his testimony before Proxmire's Senate Committee on Banking, Housing and Urban Affairs. I explained the general situation and expressed the concern of CFTC over the concentrations in silver and described the actions taken by the exchanges.

Later the same day, I talked with Peter Keir who said he was also talking on behalf of the Chairman. I explained the situation. I pointed out that while we were concerned about the silver market situation, we thought the problem was primarily the large acquisitions by speculators of bullion. I told him it appears the cash market is pushing the futures. The FED appeared to be concerned mainly about gold and not silver.

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 254-6316

September 26, 1979

MEMORANDUM TO: Files

FROM: Read P. Dunn, Jr.

I called Peter Keir, the Federal Reserve Board's representative for the Interagency Committee, on September 21st to inquire if the FED had any concerns about the futures markets in silver and gold. After checking, he reported that the FED was inclined to look on silver as just another commodity and did not pay special attention to it. They followed gold more closely. (See my memorandum of September 26th to Chairman Stone on 'Federal Agency Action to Silver and Gold Prices.'

September 26, 1979

MEMORANDUM TO: Chairman Stone
Commissioner Martin
Commissioner Gartner
Vern Pherson

FROM: Read P. Dunn, Jr.

SUBJECT: Federal Agency Action to Silver and Gold Prices

On Friday, September 21, I talked with Dick Kelly, Deputy Assistant Secretary for Debt Management, and Lyle Widman, Deputy Assistant Secretary for International Monetary Affairs at Treasury Department, about the recent action in the gold and silver markets to see what concern they have. Widman said they consider gold and silver are now commodities since neither are currently used as currency basis and should be considered as commodities. They believe that people and even institutions in many countries are selling dollars and buying gold and silver, especially in the Middle East and that this may be putting added pressure on the dollar. However, the indirect psychological effect may be greater than the direct effect. They would be concerned if they saw or thought foreign central banks were moving out of dollars into gold as this might indicate a new effort to monetize gold, but they have not noticed any significant central bank activity in this area.

Treasury does not follow silver.

Peter Keir gave me a similar report on the Federal Reserve Board's attitude a few days earlier.

April 9, 1980

Chronology of Read Dunn's Discussions with Treasury Department and Federal Reserve Board Regarding Silver, Gold and Financial Instrument Futures

September 1979 to Present

Date	Type	Name
9/19/79	Telephone	Robert Mundheim, General Counsel Treasury Dept.
9/19/79	Tel.	Peter Keir, Assistant to the Board Federal Reserve Board (FED)
9/19/79	Tel.	Robert Mundheim
9/20/79	Tel.	Peter Keir
9/21/79	Tel.	Dick Kelly, Deputy Assistant Secretary for Debt Management and Lyle Widman, Deputy Assistant Secretary for International Monetary Affairs at Treasury
9/21/79	Tel.	Peter Keir
9/24/79	Tel.	Robert Mundheim
10/11/79	Tel.	Dick Kelly
10/15/79	Tel.	Gerald Corrigan, Assistant to Chairman Volcker, FED
10/15/79	Tel.	Peter Keir
10/16/79	Tel.	Gerald Corrigan
10/16/79	Tel.	Fred Struble, Assistant Director for Government Finance, FED
10/16/79	Meeting	Anthony Solomon, Under Secretary for Monetary Affairs and Lyle Widman, Deputy Assistant Secretary for International Monetary Affairs at Treasury Fred Struble, FED Commissioner Dunn & John Mielke, CFTC

Date	Type	Name
10/22/79	Tel.	Fred Struble, FED
10/22/79	Tel.	Anthony Solomon, Treasury Dept.
10/22/79	Tel.	Fred Struble
10/23/79	Tel.	Robert Mundheim, Treasury Dept.
10/23/79	Tel.	Fred Struble
10/23/79	Tel.	Fred Struble
10/26/79	Tel.	Peter Keir, FED
10/26/79	Tel.	Anthony Solomon
10/26/79	Tel.	Jeff Gordon, Special Assistant to the General Counsel at Treasury
10/29/79	Tel.	Lyle Widman, Treasury
10/30/79	Tel.	Jeff Gordon
10/31/79	Tel.	Robert Mundheim
11/19/79	Tel.	Peter Keir
11/23/79	Tel.	Peter Keir
11/26/79	Tel.	Peter Keir
11/26/79	Meeting	Henry Wallich, Governor of FED Peter Keir, FED
12/4/79	Tel.	Fred Struble
12/5/79	Tel.	Fred Struble
12/7/79	Tel.	Gerald Corrigan, FED
12/7/79	Meeting	Gerald Corrigan, FED Commissioner Dunn & John Mielke, CFTC
12/10/79	Tel.	Robert Mundheim
12/17/79	Tel.	Peter Keir

Date	Type	Name
12/20/79	Meeting	Commissioner Dunn, Barbara Leventhal and Joan Loiseaux of CFTC, Commissioner Irving Pollack, Eric Reuter (OGC) and Steve Levey of SEC Robert Mundheim and Jeff Gordon of Treasury Dept. and Peter Keir, Don Kohn and Bob Rewald of FED
1/8/80	Tel.	Don Kohn, Capital Market Section, FED
1/18/80	Tel.	Peter Keir, FED
2/7/80	Tel.	Peter Keir
2/13/80	Tel.	Robert Mundheim, Treasury Dept.
2/21/80	Tel.	Robert Mundheim
3/24/80	Lunch	Robert Mundheim
3/31/80	Tel.	Robert Carswell, Deputy Secretary of Treasury

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 254-6318

July 27, 1979

Mr. Robert H. Mundheim
General Counsel
U. S. Department of Treasury
Room 3000
Washington, D.C. 20220

Dear Bob:

On behalf of the Commission, I wish to thank the Treasury and the Federal Reserve Board for the study and recommendations on Treasury Futures Markets. The Commissioners and the staff commented on the professional quality and constructive nature of the study. The recommendations were helpful to the Commission in reaching its final decisions on new applications for financial futures.

All the views and recommendations contained in the study were carefully considered by the Commission and discussed with Exchanges that had applications pending for financial instruments. As a result, a number of changes were made in the Exchange submissions. The Commission also made several changes in its procedures and requirements. As you know, the Commission subsequently approved note contracts on the CME and CBOT and 90 day bill contracts on ACE and Comex.

The note and the bill contracts finally approved by the Commission and the Commission procedures adopted, in my opinion, conform substantially with the specific recommendations made by the Treasury and the Federal Reserve Board. In some cases, the objectives of the recommendations were achieved in a slightly different manner than had been suggested but the results should be substantially the same. The more general recommendations for surveillance and review are in the process of being implemented.

We look forward to a close cooperation with both the Treasury and the Federal Reserve Board in monitoring the performance of these contracts. In our surveillance of the cash markets and studies of the impact of the futures on the cash, as we have discussed, we will have to rely heavily on the Treasury and the Federal Reserve Board for data. I understand the staffs are working together to develop surveillance procedures.

In this connection, we urge the Treasury to maintain and improve, to the extent feasible, its Survey of Ownership of Treasury Securities. Such information will be extremely helpful in estimating deliverable supply, particularly in notes. I can not envision comparable data being developed otherwise. I have suggested our staff discuss this in detail with your specialist.

Your personal interest and cooperation in these efforts are greatly appreciated.

I am taking the liberty of sending a copy of this letter to Mr. Peter Keir at the Federal Reserve Board.

Sincerely,

READ P. DUNN, JR.
Commissioner

cc: Peter Keir

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 254-6318

April 4, 1979

MEMORANDUM TO: Gary Seevers

FROM: Read P. Dunn, Jr.

Attached is my report of discussions with the Treasury, Federal Reserve Board and SEC pursuant to the request of Chairman Bagley to implement the interagency consultation envisioned by the recent amendment to the statute.

This report covers the period from August 31, 1978, through March 13, 1979.

cc: Commissioners
Jack Gaine
Don Tendick
Vern Pherson
Jack Field
Hugh Cadden
Michael Caughlin

STATEMENT OF READ DUNN
COMMISSIONER
COMMODITY FUTURES TRADING COMMISSION
ON CONSULTATIONS WITH THE
TREASURY, FEDERAL RESERVE BOARD AND SEC

MARCH 22, 1979

INTRODUCTION

Even before the CFTC reauthorization was completed, the then Chairman, William Bagley, requested CFTC Vice Chairman Gary Seevers and me to explore the possibilities of consulting with the SEC, Treasury and Federal Reserve Board on matters of mutual interest as envisioned by the provisions in the House Bill.

Commissioner Seevers and I met on August 31, 1978, with Charles Partee, Governor of the Federal Reserve Board, and Peter Keir of his staff and on September 13 met with Harold Williams, Chairman of the SEC, and later with Robert Carswell, Deputy Secretary of Treasury, Richard Kelly and Frank Cavanaugh of Treasury to discuss the best and most effective means of implementing the consultation requirements of the bill which, it was presumed at that time, would become law. All those contacted favored establishing a liaison committee which could meet as appeared advisable to discuss broad policy aspects of matters of mutual interest. It was the general opinion that the Policy Group on Financial Instrument Futures should be small with representatives at the policy level and should proceed informally as a consulting group and not as an action body. It was further felt that the official views of the respective agencies should continue to be transmitted in writing.

The proposal for the informal Policy Group was reported to the other CFTC Commissioners and was accepted. Subsequently, the Policy Group on Financial Instrument Futures was formed, consisting of Irving Pollack, Commissioner of SEC; Robert Mundheim, General Counsel of Treasury; Peter Keir, Assistant to the Board, Federal Reserve Board; and Read Dunn, Commissioner of CFTC. I was asked to serve as Chairman. It was agreed that members might bring associates from their agencies if and when it appeared desirable considering the subjects to be discussed. Peter Keir asked that Fred Struble from his agency be included.

The first meeting of the Policy Group on Financial Instrument Futures was held at CFTC on October 19. At that time Vernon Pherson, CFTC's Chief Economist, reviewed the programs and operations of CFTC with particular emphasis on economic purpose and market surveillance. He distributed copies of various studies and reports on market regulation by CFTC and others. The survey of the futures markets on financial instruments by Ron Hobson, CFTC Economist, was explained in detail. It was agreed the Policy Group should meet from time to time, as appeared to be desirable, to discuss policy aspects of CFTC programs and contract market applications for commodity options, stock index futures and financial or interest rate futures. Robert Mundheim suggested CFTC organize a seminar to explain for Treasury staff, and any others from the other agencies, commodity futures and their regulation. Irving Pollack suggested a meeting with CFTC program staff for SEC specialists to review the findings and conclusions of its options study. It was noted that CFTC had already scheduled a hearing on stock index futures and Commissioner Pollack agreed to arrange for someone from SEC to testify. At the meeting Peter Keir outlined broadly the joint study of the impact of financial futures on the cash markets for federal securities which the Board and the Treasury jointly intended to undertake. While the study would be undertaken by the staffs of the two agencies he indicated technical advice and assistance would be needed from CFTC. He indicated they expected the study to be completed by June of 1979.

The CFTC hearing on stock index futures was held as scheduled October 25. Ralph Ferrara, General Counsel of SEC, testified. (See transcript of hearing for details.)

CFTC discussed the question of proliferation of contracts at the regular Commission Meetings of November 7 and 28 and in consideration of the impending study of financial futures markets by the Treasury and the Federal Reserve Board decided to delay consideration of any of these proposals for approximately three months. It was agreed to schedule the first proposal for four-year notes by the CME for early March 1979.

Pursuant to the agreement for staff consultation and technical assistance following the Policy Group meeting, I met in my office November 21 with Anthony Vignola and Charles Dale from Treasury to discuss in detail CFTC surveillance and reporting. Charlie Robinson, Ron Hobson, Irving Hankin, Muff Rosen and Blake Imel from CFTC also attended.

The seminar requested by the Treasury representative was held at CFTC on December 14 with Robert Mundheim, Irving Pollack, Peter Keir and about 30 members of their professional staffs attending. Commissioner Gary Seevers and I, Vernon Pherson, and Ron Hobson explained the economic purpose of commodity futures and the objectives and general procedures of CFTC regulation. General discussion followed which pointed out differences in the approach by CFTC and the SEC with regard to regulation. The second part of the seminar began with a panel of five industry experts who use financial futures who told why they use these markets and how. The panelists were:

1. James G. Wilson, Senior Vice President, Equibank, Pittsburgh, Pa.
2. John Ashenfelter, Portfolio Manager, Mercantile Trust, St. Louis, Mo.
3. Dr. Kenneth Plant, Vice President - Research, Federal Home Mortgage Co., Wash., D.C.
4. Lawrence Geharty, Senior Vice President, First Pennsylvania Bank, Philadelphia, Pa.
5. Tom Strauss, Salomon Brothers, New York, N. Y.

Questions and answers and a general discussion followed the panel presentation. Representatives of the other agencies indicated the seminar had improved their understanding of the purposes and the operation of financial futures; however, it was evident that some still had questions and some reservations. For instance, Treasury representatives still had reservations about the effect on its responsibility to manage the public debt, especially its flexibility to vary the issue schedule. The Board still questioned the impact of futures on cash prices and the SEC still expressed concern over the protection of small speculators.

The meeting suggested by SEC on options was held at CFTC on December 21. At this time, Richard Teberg, Richard Weingarten, John Wheeler and Tom Loughran of the SEC staff that studied options explained how the SEC study of options on securities was conducted and discussed the principal conclusions and staff recommendations. At that time, the study had not been approved by the SEC. About 20 top staff from CFTC and I attended. Other Commissioners attended from time to time. The study was approved and released by the SEC about two months later and is available.

On January 17, 1979, a special meeting was held in my office at the suggestion of the Treasury representative following the seminar to compare and contrast the regulatory objectives and procedures of the SEC in the securities area and the CFTC in commodities. Hope was expressed that a study of the subject could be made by the respective staffs that would include some evaluation. Effort should be made, it was stated, to avoid regulations becoming ends in themselves. The meeting was attended by Martin Moskowitz, SEC; Peter Keir and Fred Struble, Federal Reserve; Steve Friedman and Phil Loomis, Treasury; and Vernon Pherson, CFTC. After a general discussion, the Treasury representatives agreed to draft a suggested outline for a staff study to be considered at another meeting of the group. The outline, later submitted as a first step, was for a comparative study of margin regulations on commodities, securities and options by the respective agencies. This is now being considered by the group.

In an effort to obtain as much information and comment as possible before consideration on March 6 of the CME application for a four-year Treasury Note, CFTC asked for a meeting with the staffs of the Treasury and the Federal Reserve making the joint study. This meeting was held at CFTC on March 1. Present from CFTC were Commissioner Seevers and myself, Vernon Pherson, Don Tendick, Ron Hobson and John Mielke; from Treasury, Frank Cavanaugh and Anthony Vignola; and from the Federal Reserve, Peter Keir, Fred Struble, Sheila Tschinkel and John Mingo. The two agencies making the study reported their investigations were virtually complete and that they are in the process of drafting their conclusions and recommendations and had some questions to ask CFTC before finalizing their recommendations. Their questions mainly concerned the manner in which CFTC calculates deliverable supply under Commission Guideline I, CFTC's statutory responsibility over the cash market and authority to obtain information on cash positions, the extent of CFTC information currently about positions in the cash market of persons with large positions in the financial futures, and the authority of CFTC and the exchanges to deal with market congestion, potential squeezes and attempted manipulation. The Federal Reserve representatives also raised questions about the extent and frequency of CFTC's surveillance of futures activities and the aggressiveness of CFTC's actions to prevent squeezes and threats of manipulation.

The CFTC representatives explained that the calculation of deliverable supply depends on the contract.

I said that the CFTC's extensive cash market jurisdiction includes, among other things, requirements relating to books and records, reporting and specific authority to bring cash market manipulation actions. However, I indicated that the CFTC has decided to confine its regular surveillance to the cash supply at delivery locations and has restricted its area of regulation to the prevention of manipulation of the cash market at delivery locations. I expressed the view that CFTC would have to look to the Treasury and the Federal Reserve for basic information on the cash market for financial instruments. However, I said that I thought the CFTC had the authority and could and should survey the cash positions of persons with large futures positions. It was agreed that this area would be studied by CFTC and the other agencies and that efforts should be made to develop a coordinated data gathering and surveillance program. I expressed the hope that CFTC could collect information on cash positions of futures market participants on an as needed basis through special calls in order to avoid needless paper work.

In regard to the questions about preventing manipulations or squeezes, the CFTC cited the broad authority of the statute, CFTC regulations and the exchange rules and mentioned that the CME had exercised its authority to breakup congestions and potential squeezes on a number of occasions. Further, the CFTC had taken action to require liquidation in coffee and had encouraged exchange action on several occasions. CFTC agreed to provide the study group with documentation of its authority to prevent manipulations or squeezes and actions which it had taken to do so in the past.

Another meeting with Vernon Pherson to develop a coordinated surveillance program was scheduled.

On March 6, Vernon Pherson, Ron Hobson and Monty Reese of CFTC met Fred Struble of the Federal Reserve and Anthony Vignola of Treasury in the CFTC offices in an effort to devise a more complete and coordinated data gathering and surveillance program for financial futures.

On March 7, I had lunch with Robert Mundheim. He had just returned from China with Secretary Blumenthal and had not had an opportunity to obtain reports from his associates on the recent interagency discussions. He expressed continuing concern over the note contracts because of his belief that a large volume of notes are normally purchased and held until maturity by small banks and not traded. In the event of a tight market situation he thought it might take a considerable premium to obtain these notes for delivery. In many cases, he explained, banks roll them over if they have the opportunity, especially if they have a loss they can roll forward. Again, I said I thought the calculation of deliverable supply based on this conjecture was highly subjective and that experience would be the best judge of the situation. He agreed to explore the subject fully with his associates.

On Thursday, March 8, Robert Mundheim of Treasury and Peter Keir of the Federal Reserve called me to express the hope that CFTC would wait for the joint Federal Reserve-Treasury study of financial futures before making a final decision on the CME proposal for four-year notes. They said their report had been drafted and was being reviewed and edited and should be finalized in a few days. The conclusions and recommendations which flow from the basic report, they said, are also being finalized and should be presented to the Federal Reserve Board of Governors and the Secretary of the Treasury for final action in a few weeks. I mentioned that even if CFTC acted on the CME notes on March 13, the agency views could be considered for other financial futures applications. They indicated that they felt action by CFTC on the CME proposal would set a precedent that would make subsequent changes difficult. I asked if we were likely to be surprised by any of the views. The answer was that the basic facts from their study would not be new to CFTC but they did not want to anticipate the final observations and conclusions of their superiors. I promised to report their communications but emphasized I could not promise what the Commission as a whole would decide.

On March 13, the Commission discussed the CME proposal for a contract on four-year notes and deferred action. (See Commission minutes.)

Following the meeting I telephoned Robert Mundheim and Peter Keir and reported the action of the Commission.

Meetings with Treasury, Federal Reserve and SEC re: Interagency Consultation

August 31, 1978, Thursday, 4:45 p.m., Dunn and Seevers met with Charles Partee, Governor, Federal Reserve Board, in his office, re: regulation of financial futures trading and procedure for consultation.

September 13, Wednesday, 2:30 p.m., Dunn and Seevers met with Robert Carswell, Deputy Secretary of Treasury, in his office, re: regulation of financial futures trading and procedure for consultation.

September 13, Wednesday, 4:00 p.m., Dunn and Seevers met with Chairman Williams of the SEC in his office, re: regulation of financial futures trading and procedure for consultation.

October 19, Thursday, 2:30 p.m., Interagency Group on Financial Instrument Futures with Dunn, Seevers, Pherson, Muff Rosen; Commissioner Irving Pollack of the SEC; Robert Mundheim, General Counsel of Treasury; and Peter Keir and Fred Struble of the Federal Reserve.

October 25, Wednesday, 10:00 a.m., Hearing on proposal for futures contract on 30-Industrial Stocks Index.

November 6, Monday, 2:00 p.m., Dunn and Robert Mundheim, General Counsel of Treasury, in Mundheim's office re: Interagency Committee.

November 6, Monday, 3:00 p.m., Dunn and Peter Keir of the Federal Reserve, in Keir's office, re: Interagency Committee.

November 21, Tuesday, 1:30 p.m., Dunn, Robinson, Hankin, Ron Hobson, Muff Rosen; Charles Dale and Tony Vignola of Treasury, re: T-Bill futures.

December 14, Thursday, from 8:30-12:35 and 2:30-5:00, seminar on Financial Futures Markets and Federal Regulation.

December 21, Thursday, 10:00-12:00, large group of CFTC staff, Richard Weingarten (not now with SEC), John Wheeler, General Counsel and Tom Loughran of SEC, re: options study.

January 17, 1979, Wednesday, 10:00 a.m., Dunn, Pherson, Martin Moskowitz of SEC, Steve Friedman and Phil Loomis of Treasury, re: basic commodity programs.

March 1, Thursday, 2:30 p.m., Dunn, Seevers, Pherson, Ron Hobson, John Mielke, Don Tendick; Peter Keir, Fred Struble, Sheila Tschinkel and John Mingo of Federal Reserve; Frank Cavanaugh and Anthony Vignola of Treasury, re: financial instrument futures.

March 6, Tuesday, 4:00 p.m., Pherson, Hobson, and Monty Reese of CPTC; Fred Struble of Federal Reserve; and Anthony Vignola of Treasury, re: common surveillance problems -- cash and futures markets.

March 7, Wednesday, 12:15 p.m., Dunn and Robert Mundheim, General Counsel of Treasury, at National Press Club.

Read Dunn's Phone Calls with Staff of Treasury, Federal Reserve and SEC re: Interagency Consultation

Tuesday, October 10, 1978	Commissioner Irving Pollack of SEC
	Peter Keir of Federal Reserve
	Robert Mundheim of Treasury
Wednesday, November 8	Peter Keir
Tuesday, November 14	Peter Keir
Thursday, November 16	Robert Mundheim
	Peter Keir
Friday, November 17	Richard Kelly of Treasury
Tuesday, November 28	Peter Keir
Wednesday, November 29	Robert Mundheim
	Robert Mundheim
Monday, December 11	Commissioner Pollack
Tuesday, December 12	Peter Keir
Wednesday, January 3, 1979	Robert Mundheim
	Richard Kelly
Thursday, January 4	Commissioner Pollack
Monday, January 8	Steve Friedman of Treasury
	Martin Moskowitz of SEC
Wednesday, January 10	Martin Moskowitz
Friday, January 12	Peter Keir
Tuesday, February 13	Peter Keir
Monday, February 26	Peter Keir
Thursday, March 8	Peter Keir
	Frank Cavanaugh of Treasury
	Robert Mundheim
Friday, March 9	Peter Keir
	Peter Keir
Monday, March 12	Peter Keir

Mr. **Rosenthal.** Do you conceive yourself as a quasi-judicial body or a regulatory body? How do you conceive yourself?

Mr. **Dunn.** There is no question that we have a judicial function. The organization has it's own court system, and I sit as a judge.

Mr. **Rosenthal.** Do you think it's appropriate that litigants before the court can come and see the judge? I'm just trying to ask if you think it's appropriate that people whom you regulate have the right, or you thought it appropriate that they could come and visit with you in the way that they did?

Mr. **Dunn.** The two ways you put the question have very different answers. I make it a policy, in fact all of us do, to have no communication with people who are, let's say, before our court, our administrative law judges.

In other words, once we have issued a formal complaint and the matter is in litigation, then we stay completely away from it, because we may have to sit in judgment as a Commission or as a Commissioner in the review of the administrative law judge's decision on appeal.

And, also, if there is a litigation against any person with whom I've had any close connections in the past, my policy is to disassociate myself.

Mr. **Rosenthal.** Let us take the example of somebody who owned a majority of the silver contracts in the United States. The potential for that person being a litigant or appearing before the Commission is rather high.

Mr. **Dunn.** Potential. I don't understand. There is a potential that you and I may be hauled up before some court or other. I hope it doesn't happen.

If you talk about potential in that way, then it means that we have no discussion with anybody that is ever involved in the market would be possible. I think that's going too far.

Mr. **Rosenthal.** It's an interesting thought.

Mr. **Dunn.** Yes.

Mr. **Rosenthal.** We'll develop that.

Mr. Martin, why don't you offer your thoughts and views so I'll know anything we've talked about or anything you think is relevant to this.

Mr. **Martin.** I think reading the deathless prose you have before you will come from Mr. Gartner rather than me.

Mr. **Rosenthal.** That's fine.

Mr. **Martin.** I do have a couple of comments and I will come back. You don't have to ask my opinion about whether we acted or whether we didn't, and so on.

But, I'm not going to—I've got a few notes here that I'll just kind of wade through in a little bit.

And at the risk of seeming to oversimplify the problem, to my mind, after stripping away the extraneous matters, the threats of impending doom that started to surface on March 26, arose from some bad business judgments previously made by one or more Commission houses.

These judgments have to do with the extension of credit, acceptance of the exposure of carrying customers positions that were so great, as to be too big for the market, and then, in effect, crying fire in a crowded theater.

In any speculative venture, whether involving securities or commodities, the dangers of pyramiding—using unrealized profits as margins with which to expand the position—are basic and should be pointed out to the customer.

I don't say that this was general throughout the whole structure here, but I think it happened in more than one case.

Mr. Rosenthal. We're talking now about the silver markets?

Mr. Martin. I'm speaking about the silver market.

Mr. Rosenthal. And you think individual innocent citizens were involved in this runup in price?

Mr. Martin. I think by the time late last year, the margins got so high, and the volatility so pronounced, that there weren't very many little people involved in this thing.

I think we found only sophisticated people and wealthy people in the market. The size and volatility of the market involved is of vital concern to any commission house in permitting a customer to assume a major position, whether hedging or speculative in nature. Has the market been, or is it likely to be, subject to congestion that might arise from a series of limit price rules?

Can the size and character of the market reasonably be expected to provide a ready exit for any reason?

These are the types of appraisals that an inexperienced trader may be unable to make, but on which his broker by virtue of his knowledge and experience, should be able to offer guidance. What happens when the commission house, rather than offering prudent counsel to the customer—albeit an experienced and wealthy customer—instead, ignores market conditions and accepts the use of unrealized profits as minimum margins on a volatile commodity?

For some time now, some of us on the Commission have tried to point out frequently and loudly, the great difficulty in trying to protect much of the public from their own stupidity and cupidity.

This is as true of a commission house as it is with the customer. There are a couple of truisms in commodities that have become cliches, but are true, nonetheless. Never have a position so big that it interferes with your sleep. Never have at risk more than you can afford to lose. This, too, is as applicable to the broker as to the customer.

The market action, normally attendant to forced liquidation of a substantial position, was compounded by public efforts to close down the markets.

These efforts were accompanied by threats of major bank failures and a general collapse of many New York Stock Exchange firms.

I cannot say what representations were made, and by whom, to Mr. Volcker or Mr. Williams. The contacts and inquiries that I made—which were limited, to avoid expanding the crisis by adding to the chorus—assured me that the bank with the greatest involvement did not plan to take precipitious action and the market would be best served by continued operation.

Indeed, the consensus was that a suspension of trade would have been disastrous. Much after the fact analysis has suggested that the rise and fall of the silver market was due to a manipulated futures market and that position limits or margin controls somehow would have prevented it. The CFTC has been monitoring silver futures since 1975.

As in our monitoring of all futures markets, the relationship between futures prices and those of the cash or physical markets has been closely observed.

During the period in question, we saw a sharp upturn in the physical and futures prices of gold, silver, platinum, and copper.

These changes were worldwide, not just in the United States. Earlier this year the Wall Street Journal carried an article discussing the sharp upturn in titanium prices. There are neither futures markets or spot calls for this metal.

During the period in question, all futures markets, metals in particular, were seeing supply and demand appraisals being modified by concerns regarding inflation and the eroding value of the dollar.

Sometimes it is hard now to reconstruct the environment in which the trading decisions were made 4 months ago.

I guess it would be appropriate at this moment to give you my thought regarding our actions. We did not pass any regulations, but we were in rather frequent contact with the exchanges involved, and I believe that as a result of our prodding and our contact with them that the exchanges did install some position limits and tried to minimize the amount of deliveries that could be taken, the position limits being smaller in the nearby month than in the deferred and the margins were raised rather sharply.

Now, I've heard the term suitability last week or a couple of weeks ago when I was here and I read it yesterday and that's an interesting thing to me in this context, because I can think of no customers that would have a harder time failing any kind of suitability tests than the kinds of people we've had in this market.

I want to quote an old sage, myself, here for a moment, if I may, regarding suitability. This is from some remarks I made a few months ago, but I think they apply today and I'll ask your indulgence, if I may just read them.

Mr. **Rosenthal.** You and Mr. Dunn have voted against suitability at Commission meetings.

Mr. **Martin.** I beg your pardon?

Mr. **Rosenthal.** You and Mr. Dunn have voted against.

Mr. **Martin.** Mr. Gartner and I.

Mr. **Rosenthal.** No.

Mr. **Martin.** I think I did, anyway.

May I tell you why?

Mr. **Rosenthal.** Please.

Mr. **Martin.** OK. Customer abuse is not necessarily antonymous with customer protection. In many quarters customer protection is a compound word, like damn Yankee.

Given half a chance, there are many who would like to extend customer protection into an opportunity for the customer to second-guess his market decisions, accepting only those which are profitable.

In my mind, customer protection should serve to shield the customer against fraud and deceit. It should protect his funds against any improper diversion. It should assure that he is made to understand the risk involved in commodities trading.

It should not, however, offer him any shelter from the consequences of his own judgment, nor should it under the guise of protection, deny him the privilege of exercising his judgment in the hope that a profit may result.

As many of you are aware, the Commission in a recent discussion regarding commodities, options, got hung up on what some like to characterize as customer protection.

Stripped of rhetoric, the disagreement concerned disclosure versus suitability. Suitability in the present context is a requirement that any trading recommendation to the customer be suitable to his financial ability.

There are those who will try to hammer the commodity community into a securities mold, who will paraphrase the security suitability requirement that the recommendations be suitable to the customer's financial goals and aims.

Now, there may be room in securities to differentiate between conservative training versus aggressive, between seeking income rather than growth.

One speculates in commodities for only one reason. Profit. If a trading advisor ever speaks to you about investing in commodities, clutch your wallet or purse, he speaks with a forked tongue.

One does not invest in commodities, one speculates in commodities.

Let us explore suitability for a moment. The only yardstick proposed in this connection is a financial one. Can the customer afford to lose the money? Now, who is best qualified to make this determination, the FCM or the customer?

I regard a financial suitability requirement as the ultimate in overregulation. If the customer intelligently and with full knowledge of the risk involved, elects to make a financial judgment in the market, who is the Federal Government to tell him that he can't.

We tolerate seductive advertising depicting the glories of an overseas vacation, arranged for on credit; the easy payment of a recreational vehicle; the discounted airfare that will cost father only an arm or a leg to take his family to the west coast.

Who in the Government stands in front of the luxury car dealer turning away the unqualified purchaser? Where is the Federal naysayer when a man's wife takes him to the furriers.

How many States advertise their lottery? But we, the CFTC, in our omniscience, are going to tell the would-be speculator that he can't put his money in commodities—he had better play bingo.

I say, explain the risk. Let me say that again, explain the risk. Then the choice should be up to the informed public.

In my mind, far more important than financial suitability, is psychological suitability—and I hear not a word about that from the proponents of financial suitability.

Are you able to accept a loss philosophically, and try another time? I once heard a securities type individual speak of the incidence of loss incurred by commodities traders as compared to those in securities.

One must bear in mind that there's a moment of truth in commodities that doesn't exist in securities. If you're long in July soybeans, you have to liquidate your position or take delivery between now and the middle of next July.

How many people own stock, have owned it for years, at an acquisition price that may or may not be cheaper than today's close, and probably isn't if you convert the acquisition price into today's dollars?

The majority of security buyers are just that, securities buyers. In commodities, one must be a trader. There are no commodity dividends, or stock splits. There's just one goal to sell it for more, or buy it for less than you paid for it.

Many commodities traders have told me that it's much more difficult for them to get out of the market than to get into it. If the market's been going against you, you hope it will get better if you wait. If the market's been going your way, you hope that it will get better if you wait.

The leverage that comes from relatively low margins in the volatility attendant to commodities markets are double edged. They offer opportunity and peril.

A successful commodities trader must be disciplined and stick to his game plan. I come back to my suitability criteria. There are many individuals who have ample funds to trade commodities, but who do not have the philosophic bend. They are the ones who should not be in commodities and they won't be for long.

I just have a couple more paragraphs. Please don't misunderstand, I insist on full risk disclosure and would severely penalize those who would perpetrate a fraud and a deceit on the public.

I must also say that I am sometimes at a loss to understand how anyone can be seduced by a sales pitch that promises a 900 percent return.

Now, one last word. I refer to Sylvia Porter in the Washington Star on September 24, last, and I excerpt as follows:

> Negligence lawyers are finding this sudden awakening to the rule of suitability a bonanza. On a contingency basis, a lawyer will take from 25 to 40 percent or more of what is received as a result of a lawsuit. Even on a fee basis, the hourly charges can result in hefty legal bills.
>
> On a relatively simple case, the lawyer's fee will come in at $1,500 to $2,000. If the case is complex, the cost can run up to $10,000 and above.
>
> And, while no tally has been made of the success of the lawsuit, the consensus is that the number of investors winning in the courthouse is not necessarily matching the upsurge in the number of cases.

Now, I told you my philosophy on protection. Protection, I think, lies with educating the customer that he knows what the risk is. It's up to him to take them.

Mr. **Rosenthal.** I think I understand your philosophy. Would you comment on the colloquy I had with Mr. Dunn about these meetings with the Hunt brothers?

Have you met with them?

Mr. **Martin.** Yes. I have met with—I'll use their first names to identify them. We're not on first-name basis.

I met with Bunker Hunt once. I met with Herbert once in my own office and I think it was he and myself for about 10 minutes. He was complaining that the market was being restricted too heavily, that he was being forced to do, or if we persisted in our course, he would be forced to liquidate some positions that he didn't want to.

Mr. **Rosenthal.** Did you meet with other commodity speculators in the same fashion?

Mr. MARTIN. Oh, yes. I meet with people in the trade whether they be speculators or hedgers or producers or whatever.

I think it's important for me to know what is going on in the market.

Mr. ROSENTHAL. Even though you may have to rule on matters in which they have a financial interest?

Mr. MARTIN. I will go with Mr. Dunn in this connection. I don't discuss matters which are at issue, not issue, which are being litigated before us.

But, many things that come up, as you mentioned the other day when you were talking to Chairman Stone. Sometimes there are—there are not always unamimous decisions on the Commission. Now, this doesn't mean that we necessarily are being in error, looking at different situations, people have different reactions. It's necessary for me sometimes to find out why is the trade doing this, what is the perception in the trade, because I sit here in Washington away from the source of the market functions except to the extent that the Government is the impetus in some market judgment.

It's necessary for me to go out and talk to these people or when they come in, to talk to them here. I talked to somebody from Hershey yesterday, just generally.

Mr. ROSENTHAL. Do you keep records of these visits?

Mr. MARTIN. Only to the extent that my secretary's log of who comes in to see me. Because, I'm not discussing something, I'm not telling them any secrets, I don't think they're telling me any secrets. They're telling me some of the things that might concern me.

And, I think it's free and open discussion. Again, I say, one has to be careful not to tell anybody anything that they can't find that we know and only we know.

Somebody's position, I don't like to discuss it. I never do discuss it at home or any place else.

Mr. ROSENTHAL. Do you think any special consideration has to be taken into account with a commodity like silver, when a dramatic decline in price can disrupt or disrupt the security markets?

Do any special precautions have to be taken in that kind of situation?

Mr. MARTIN. Very generalized again, and I'm sorry, because I do oversimplify and it isn't quite that simple. But, when you see a market rise as the silver market did, not always, but it's not unusual to find a sharp adjustment to that sort of thing, so I would be foolish to say I predicted it or anything like that, I didn't. But, I wasn't surprised. Possibly I was surprised in the way it happened, but this is the sort of thing that rather surprises me when I see so many sophisticated people in the market, including the commission houses that were handling these large positions.

Mr. ROSENTHAL. What do you think—I still don't think you've answered the question.

Mr. MARTIN. OK. I'm sorry.

Mr. ROSENTHAL. In other words, do you have to take special concern or special caution when a commodity can be disruptive if there's a decline, and a precipitous decline on a commodity can be disruptive in the security market, as the situation happened in silver?

Mr. **Martin**. I'm not sure. Now, it did disrupt the securities market because some commission houses got themselves exposed to a point that I don't think they should have. We didn't see every commission house in trouble.

We saw one or two or three.

Mr. **Rosenthal**. Do you think Mr. Volcker, Mr. Williams, and Mr. Carswell were overly concerned or overly anxiety ridden when this thing took place?

Mr. **Martin**. I don't know what they were being told. I think it was suggested to them that major banks would go under. I think it was suggested to them that much of Wall Street would disappear. Now, I don't know if that was true or not.

I don't think there were as many firms involved in this sort of thing that may have been suggested originally to Mr. Williams, Carswell, and Volcker.

I don't know that, you know, I wasn't privy to the conversations.

Mr. **Rosenthal**. Did any small firms go under?

Mr. **Martin**. I don't think anybody went under.

Mr. **Rosenthal**. Well, there's some little company, a $4½ million company went out of business, but that's nothing.

Mr. **Martin**. No; I'm sorry. And I don't know—was this a commission house?

Mr. **Rosenthal**. No, no; I think it was an investor, wasn't it? A metals company.

Mr. **Martin**. No.

Mr. **Rosenthal**. Is your philosophy as a regulator essentially not to regulate?

Mr. **Martin**. Oh, no. I think to regulate, but not to try to move in and call all the shots. I think the market—I'm not going to say be left alone, I think it should be supervised.

I think the market is bigger, and this is an old cliche too, it's bigger than anybody. I think, not at all. I think there are times we should definitely regulate.

Mr. **Rosenthal**. Like when?

Mr. **Martin**. Like what we were involved in with the silver market, in that while we did not do it, I think we could take some credit for it. The exchange is the one that took the action at our prodding, as I said.

Mr. **Rosenthal**. Let's just set the record straight. The CFTC did nothing in the silver market.

Mr. **Martin**. That's not so. I'll disagree.

Mr. **Rosenthal**. With Dunn?

Mr. **Martin**. With Mr. Dunn, yes.

Mr. **Rosenthal**. What did you do?

Mr. **Martin**. We met with the exchanges and by pressuring the exchanges. For us to act would have required the pronouncement of an emergency and spent some time in getting something done.

Instead, we pressed the exchanges into taking some action that was done immediately. It resulted in some lawsuits being brought against the exchanges, or threatened. To reduce the sizes of position and to reduce the size of the immediate positions.

Mr. **Rosenthal**. When was this? When did you take that action?

Mr. MARTIN. It was last—the last action came in mid-January, I believe, but there had been continuing pressures and the exchanges had been working to try to——

Mr. ROSENTHAL. Who pressured the exchanges?

Mr. MARTIN. The Commission.

Mr. ROSENTHAL. Has the Commission sent a letter?

Mr. MARTIN. No. Probably—we had a meeting in Washington.

Mr. ROSENTHAL. And what did you do?

Mr. MARTIN. I beg——

Mr. ROSENTHAL. I have to know for the record what you did.

Mr. MARTIN. We asked the exchanges what they were going to do.

Mr. ROSENTHAL. You have a copy of the letter?

Mr. MARTIN. It was verbal.

Mr. ROSENTHAL. Well, as a commission, you're a body governed by administrative acts, Administrative Procedure Act. I mean, you can't deal verbally.

Who did you deal with? Who did you talk to?

Mr. MARTIN. The Commission—I'm sorry. The exchanges are the ones that took the action.

Mr. ROSENTHAL. No, but you said that the Commission did something. I'd like to see a record of what you did.

Mr. MARTIN. I don't—OK. We did not take a vote and take an action. We talked to the exchanges.

Mr. ROSENTHAL. Who talked to the exchanges?

Mr. MARTIN. The Commission, all four of us.

Mr. ROSENTHAL. The four of you went to New York and Chicago?

Mr. MARTIN. The three exchanges involved, the New York Commodity Exchange, the Chicago Board of Trade, and the Mid-American Commodity Exchange from Chicago. Officials from there came here and met with us—with the Commission.

Mr. ROSENTHAL. Are there any records of those meetings?

Mr. MARTIN. Yes.

Mr. ROSENTHAL. Of who was there and everything?

Mr. MARTIN. I'm sure there is; I don't have it with me. I'm sure it can be furnished to you.

[The information follows:]

Commodity Futures Trading Commission Minutes

Tuesday, January 8, 1980 9:35 AM 8th floor conference room

Commissioners:	Chairman James Stone, Commissioner Read Dunn, Commissioner Robert Martin, Commissioner David Gartner
Staff:	John Manley, John Mielke, Don Tendick, Jack Gaine, James Culver, Jean Webb

The Commission voted unanimously to close the meeting and to hold the meeting on less than seven days notice.

CLOSED: 1. The Commission continued the discussion of January 6 regarding the suspension of the grain markets. It was agreed that the opening of the markets should not be delayed beyond Tuesday, January 8, 1980.

2. Silver

The Commission was briefed by the staff on the current silver positions.

The Commission continued the meeting at 10:10 AM in the 5th floor hearing room

Commissioners:	Chairman James Stone, Commissioner Read Dunn, Commissioner Robert Martin, Commissioner David Gartner
Staff:	Jack Gaine, Pat Nicolette, John Mielke, John Manley, Don Tendick, James Culver, Jean Webb

Exchange Participants:

MidAmerica Commodity Exchange	Donald G. Nash Mark K. Bruscke David H. Morgan
Chicago Board of Trade	Robert K. Wilmouth John F. Gilmore John Stassen
Commodity Exchange, Inc.	Andrew F. Brimmer Lee Berendt John F. O'Neal David Rutledge Mark Buckstein

The representatives of the three exchanges briefed the Commission on the silver markets and the action being proposed by the Chicago Board of Trade and the Commodity Exchange.

Mr. **Rosenthal**. But as a duly authorized legal body, you took no legal action of any kind? You jawboned the exchanges you say.

Mr. **Martin**. We accomplished the action.

Mr. **Rosenthal**. That's not what I asked.

Mr. **Martin**. We did not take a vote and pass a regulation or anything like that. We did not take that kind of action.

Mr. **Rosenthal**. You say that the four of you—the Commission—met over lunch and talked? What was the environment?

Mr. **Martin**. The environment was our hearing room where we normally hold our Commission meetings on the fifth floor in our building.

Mr. **Rosenthal**. And you called these people in?

Mr. **Martin**. Yes.

Mr. **Rosenthal**. Do other—I'm not familiar with this. Do other regulatory agencies follow these kinds of procedures?

Mr. **Martin**. One of the reasons we did this, sir, was because of the volatility in the silver market, that we didn't want to get involved in something that the mere expression that the CFTC is calling somebody is going to create a market disturbance.

Mr. **Rosenthal**. But you did this 7 months after you first discussed it at a Commission hearing. When did you have this jawboning exercise?

Mr. **Martin**. That was one that I can recall specifically and it was——

Mr. **Rosenthal**. When? What date?

Mr. **Martin**. I beg your pardon?

Mr. **Rosenthal**. What date?

Mr. **Martin**. January 7, I'm told.

Mr. **Rosenthal**. Now, the first meeting that I'm aware of you discussed this matter as some seriousness was July 27, 1979. So, then you're talking of 6 months later you did something.

And the fact is that two exchanges took exactly different kind of action.

Mr. **Martin**. That's right.

We didn't tell them what to do. We left them, because there is not a—it isn't a very simple thing. So, we let them work it out and in each case it had an effect.

Mr. **Rosenthal**. Each exchange did something different?

Mr. **Martin**. That's right. And in each case, it started to slow the market down. I don't think we can take full credit for that because I think the interest rate had a definite bearing too.

All of these things put together—it's like which is more important, the stomach or the liver.

Mr. **Rosenthal**. I'm interested fundamentally in your own concept of your position in the agency. Are you principally a regulator or a persuader?

I never heard of this before where the four members of an agency meet with interested people in the private sector and persuade them to do things.

Mr. **Martin**. These were not interested people.

Mr. **Rosenthal**. The exchanges?

Mr. **Martin**. That's right. We called in nobody who had a position so that there wouldn't be somebody who was getting any free——

Mr. **Rosenthal.** Was this meeting that you had with them open to the public?

Mr. **Martin.** No.

Mr. **Rosenthal.** Why not?

Mr. **Martin.** For this reason that I just told you, that we don't want to have this sort of thing—just the announcement of such a meeting would have market impact.

I think this was our judgment that this sort of thing had to be done quietly or you're going to have all sorts of market activity. I have no idea in which way in the market.

Mr. **Rosenthal.** No, no. You may be right as to the market. I'm just interested in your philosophy of your responsibility, legal responsibility as a commission. It's your view that as a commission you can meet with exchanges or private people and talk to them, exercising influence that way?

Mr. **Martin.** Only because of the situation at this time.

Mr. **Rosenthal.** But for 6 months at that time?

Mr. **Martin.** There didn't seem to be a reason to do anything previously.

Mr. **Rosenthal.** But on July 27, the Commission records reveal that some of you thought it was a serious matter?

Mr. **Martin.** We talked about it. I don't know what the price was at that time.

No, no, this is something to look at. What was the price?

Mr. **Rosenthal.** That's why we're here.

Mr. **Martin.** I don't have it with me, I'm sorry. I can assemble this for you?

Mr. **Rosenthal.** Well, in July at the first meeting, I'm told the price was $9.50 when you first expressed an interest.

Mr. **Martin.** And where was it in—I don't know, maybe it was $18. I have no idea. I'm sorry. I didn't bring a log and I'm going to suspect that we've had contacts. Our staff has had contacts with the exchange staff.

Mr. **Rosenthal.** Did your staff people meet with the Hunts too?

Mr. **Martin.** Why sure they did, to ask them what their positions were, their intentions, how much, in fact, we would have them, all the Hunts, virtually every week to find out what they've been doing, how much silver did they—have they bought.

Mr. **Rosenthal.** Is it your view that there are times when the Commission should not do anything officially because it would be disruptive of the market?

Mr. **Martin.** Yes.

Mr. **Rosenthal.** Well, how does the public gain any accountability of your action?

Mr. **Martin.** The public——

Mr. **Rosenthal.** How would we know if you're ever doing anything?

Mr. **Martin.** We keep records. We make them——

Mr. **Rosenthal.** But you don't make them public?

Mr. **Martin.** Surely.

Mr. **Rosenthal.** You don't advertise what you're doing.

Mr. **Martin.** Most of our meetings are held in public.

Mr. **Rosenthal.** Well, then were there meetings where you did something?

Mr. **Martin**. One meeting.

Mr. **Rosenthal**. One meeting? I'm trying to find out your concept because I think an awful lot of attention will have to be paid to some restructuring, reorganization of the Commission.

Mr. **Martin**. I think that our conduct in this case was the responsible thing to have done. And I think it would have been very irresponsible, the equivalent of shouting fire in a crowded theater, if we announced that we're going to hold a meeting, we don't know what we are going to hear.

Mr. **Rosenthal**. Do you think maybe during the 6-month period you should have said to the Hunts, how about slowing down a little your acquisition of silver or don't you think you have that authority?

Mr. **Martin**. I don't think we have that authority.

Mr. **Rosenthal**. But if you see some individuals garnering a major share of a precious metal, do you think you should do nothing?

Mr. **Martin**. When they violate a law?

Mr. **Rosenthal**. Do you think you should do anything when they garner a major share of a precious commodity?

Is it your view that you should do nothing? There's nothing wrong in that view. That's a view.

Mr. **Martin**. No. Let me come back—when we can legally take an action, I think we would.

Mr. **Rosenthal**. But under the statute you can prevent a cornering of a market. In the national public interest, it says.

I don't know. Mr. Gartner?

Mr. **Gartner**. Mr. Chairman, I submitted a statement to staff yesterday which I ask that the subcommittee make a part——

Mr. **Rosenthal**. Would you like to read it? It's a very short statement and it's pungent.

Mr. **Gartner**. I'd be happy to read it, Mr. Chairman, and I have a very brief addition to it that I just completed last night. So, if you'll permit me, I'll read the statement.

Mr. **Rosenthal**. Why don't you read it?

Mr. **Gartner**. All right, sir.

The Commodity Futures Trading Commission has nothing to apologize for with respect to its role in connection with recent reverberations in the silver futures market. While the fact that we permitted the normal forces of supply and demand to work their will may be unusual for a Government regulatory agency, this course of action nonetheless was the responsible one to take.

Consequently, this is no time to advocate solutions to problems that do not exist. The silver phenomenon was free enterprise at its finest hour. It demonstrated that the system works.

There are those, however, who take the position that Government necessarily erred because Government did not act. This point of view is embodied in a theoretical notion that Government intervention is the only solution. Those who hold this unenlightened point of view are the victims of artless simplicity.

The Securities and Exchange Commission has no additional role in commodity futures. Neither does the Federal Reserve System nor the Department of the Treasury. Congress made that quite clear in 1974 after careful thought and deliberation. The CFTC is capable of doing its job and capable of doing it with the tools it presently has at hand.

The silver saga of 1980 will be discussed and debated for a long time. Hopefully, a consensus will emerge that this was one occasion when Government, in its wisdom, exercised restraint and thereby did not lead a difficult market situation into a state of chaos.

Mr. **Rosenthal.** Let me express to you my dilemma. Your position is quite clear. Some may disagree with it, others may not, but it is quite clear.

I'm reading from the annual report of the CFTC and this is what it says, and I quote:

> Regulatory objectives. CFTC has a variety of responsibilities as the futures industry regulator. To achieve the primary objectives envisioned by Congress, the Commodity Futures Trading Commission Act of 1974, Public Law 93-463 was designed to prevent commodity price manipulation and market corners, and curb unwarranted price changes caused by excessive large trader speculation.

Did you do that?

Mr. **Gartner.** Well, sir, we have an investigation underway right now with respect to this whole matter, as I think the SEC also does.

I don't know that we have any evidence at this point that there was any manipulation in the marketplace. Certainly we had been advised by staff week after week after week at our surveillance meetings that there was no emergency and——

Mr. **Rosenthal.** Was there a cornering of the market?

Mr. **Gartner.** Well, sir, I can't answer that question.

Mr. **Rosenthal.** Because you don't know anything as of now?

Mr. **Gartner.** Well, sir, I wouldn't be able to answer that question until our investigation has been completed. I would say that as of right now——

Mr. **Rosenthal.** Without having the investigation completed, how can you say that the silver phenomena was free enterprise at its finest hour? You don't know.

Mr. **Gartner.** Well, as of right now, sir, there appears to be no evidence that there was a corner or a squeeze or a manipulation in the markets.

Mr. **Rosenthal.** Have you met with the Hunts too?

Mr. **Gartner.** No, sir.

Mr. **Rosenthal.** You've never met with them?

Mr. **Gartner.** That was my prepared statement. If I may continue with the additional remarks that I have, it's very brief.

In evaluating the recent events in the silver futures market, one thing stands out and that is that no one other than large speculators and their unwary brokers got hurt. The prices of other commodities were not adversely affected.

Other commodity brokers were not hurt. Securities firms were not hurt. And there was no panic, except in the minds of those prepared for shellshock.

As far as the risk to the brokerage houses' customers was concerned, there was none. There well may have been risk to the brokers' shareholders, but the same risk exists for any stock corporation in which the management has broad corporate authority to channel the company's assets into speculative ventures.

Market forces came into play, as they invariably would whenever a commodity becomes grossly undervalued, to stabilize prices and then to push them gradually back to less volatile levels.

The market, in a very real sense, cured itself. However, had the market not rectified the problem, the world's bullion dealers and investment banking firms surely would have developed a plan to purchase the entire overhang of silver at reasonable prices. I understand that discussions about this were in progress and perspective participants included representatives of major New York and Chicago banks, and bullion dealers.

In this regard, we might learn a lesson from the history of the silver market. In 1913 a group was formed by the oldest British bullion dealer to prevent the bankruptcy of the firm that carried the accounts controlled by Chunilal Saraya, chairman of the India Specie Bank.

Saraya had attempted to corner the silver market and failed—this was in 1913—holding a position of nearly 30 million ounces of silver.

After he committed suicide and his bank was liquidated, the bullion dealers group took up Saraya's position and over the next 6 months sold the silver at a profit.

One of the participants in this bailout commented—

> It was considered very satisfactory that so large a liability should have been disposed of in so short a time, leaving as it did the silver market in a much sounder position than it had been for several years.

In the present instance, the largest brokerage houses in the country would have been happy to pick up the pieces for any broker who had difficulty and they might have spent money to do so.

The only group which lost in the sharp decline of the silver futures market were longs who overextended themselves. But, these people entered the market assuming that risk and hopefully were prepared to pay the price. The entire episode went by without any crippling consequences.

But had there been a precipitous rise in margin, there might have been forced liquidation of short positions, adding to the upward pressure on the markets.

I might add that the margin levels were during this period exceptionally high, indeed historically high, and there were numerous complaints from the longs that margin levels were far in excess of what was prudent.

All in all, not only did the market survive, but it demonstrated its resiliency. Certain longs reportedly lost money and the American public seems to have profited.

The general public took its jewelry and flatware and sold it to the country's chain bullion dealers who in turn sold it on the futures market to the substantial longs.

To consider changing a system which survived at a time when the market witnessed an 80-percent decrease in price is to seek a solution where none is required.

If the goal is to protect the funds of those who carried commodities accounts, that goal was met.

If the goal is to protect the integrity of the market place, clearly there is no need for change. If, however, the goal is to insure that entrepreneurs, such as the brokers, will always survive, then not only should new measures be adopted, but a new theory of capitalism should be created.

Mr. **Rosenthal.** Do you have any comments, Mr. Stone? Do you have any overwhelming compulsion to add or comment?

Mr. **Stone.** Well, I'm sure that you are aware from the discussion that has just occurred here that there are some philosophical differences within the Commission.

My view is that the financial fabric of the United States was endangered. This was not a situation that we can look back on as one that caused no danger to anyone. It is not a situation after which the issues should be submerged. I feel very strongly that change is required.

I feel strongly that position limits and margins need to be considered and that the question of how much speculation we should permit in commodities markets is an extremely important one for the public sector to address.

I would also like to comment that perhaps today's discussion at this table has focused attention on the right issue rather than one which I think has mistakenly arisen here.

I think one of the things that all of us at this table would agree on, whatever our philosphical differences, is that our staff did a fine and competent job as this emergency situation developed. To the extent that anyone wishes to criticize any action the Commission did or did not take, the four of us at this table are the ones that should bear the responsibility.

I would not like to see, as I think has mistakenly occurred, anyone color our staff in a bad light for anything that happened. They served us extraordinarily well during this situation. I'm sure that, if you checked with the other agencies involved, they would tell you that our staff performed in an exemplary manner as the situation developed.

Mr. **Rosenthal.** Mr. Jeffries?

Mr. **Jeffries.** Mr. Chairman. Thank you. I've been sitting here for an hour and 25 minutes. It's been enjoyable and rather enlightening, I guess.

But I heard the words "impending doom," and I might mention in passing that I have just returned from my district. Let me tell you that interest rates, by Government edict, are really dooming Americans.

Also I've heard, as I came in, that people are being induced to participate in the futures market. I'm wondering if it's the same type of inducement that draws people to the stock market, and banks.

How far does inducement go? What should we as Americans in a free nation consider as inducement? Also, I've heard about the problem of money as a store of value mentioned. Could it be that overregulation and poor money management here in Washington, might not be the cause of the problem that we're talking about here?

And I see you nodding your head, Mr. Dunn, and I agree with you 110 percent.

Mr. Martin, I applaud you as a member of a Government agency, with your seeming feel for the free market system. It's really a pleasure to me to see those in Government who really believe in a market economy.

So, I would just ask the question. In your opinion—any one of you might answer this, if you wish—how badly have the markets been hurt?

Who suffered? Anybody care to answer that,

Mr. MARTIN. I will try. I don't think I can say they have necessarily been hurt, but we will find that they have taken on a somewhat different color as a result of this and I'll speak of agricultural commodities.

I think we are seeing now, and regardless of how one sides with this, the cost of carrying an inventory is much greater. Therefore, we'll see that spreads—the relationship of one future to another, will change.

But, who owns the crop now? The processor probably is trying to own less of the crop at a given time because he's got to go to the bank to finance his inventory, the flour miller or the soybean crusher.

At the same time then, the farmer is probably, of course, carrying this because he doesn't want to sell at the price he's getting for it, but on the other hand, it's costing him to carry it.

Mr. JEFFRIES. That's right, he can't carry it now, either.

Mr. MARTIN. Well, that's right. So, possibly, he's having to have a fire sale. But as far as the functions of the futures market go, I think the futures markets merely appraise the effect of the phenomena that you speak of.

Mr. JEFFRIES. So many of these problems stem from the rules and regulations of the Government.

Mr. MARTIN. The Government is not one of the least of market influences that we find here in America.

Mr. JEFFRIES. That's right. I think that's all, Mr. Chairman.

Mr. ROSENTHAL. I just have a couple of questions.

Mr. Gartner, do you believe that officials of the Treasury, the FED, the SEC, should have access to CFTC surveillance meetings?

Mr. GARTNER. To the tapes of the surveillance meetings or to be present at surveillance meetings?

Mr. ROSENTHAL. Well, to all material and information that you have?

Mr. GARTNER. I feel that other agencies of Government, whoever they might be, should be provided access to information we have even if section 8 material is contained on a need-to-know basis and I have consistently voted to provide that information to these other agencies.

Mr. ROSENTHAL. Can you explain to me the following series of events? On March 28, 1980, the Commission voted 4 to 0 to comply fully with the request from Senator Stewart to report by April 4, documenting the situation of the silver market for the 6-month period preceeding March 27, 1980.

And on the same day the Commission voted 3 to 1, Chairman Stone dissenting, to deny the release of the exact same material to this subcommittee.

Mr. GARTNER. Mr. Chairman, Senator Stewart specifically asked that the information that we provided to him be devoid of any and all section 8 material. The information you were requesting did contain section 8 material which accounts for the——

Mr. ROSENTHAL. That's not how I read the Commission minutes because in the Commission minutes it says, in direction to the General Counsel, and Executive Director as the coordinator of this report—this is referring now to Stewart's request.

Mr. GARTNER. Yes, sir.

Mr. ROSENTHAL. The Commission agreed that any section 8 material included in the report shall be brought to the Commission separately before releasing it.

Mr. GARTNER. That means that if there were any section 8 material that was included in the staff report, it should be brought to the Commission to vote as to whether or not that material should be sent to Senator Stewart.

Mr. ROSENTHAL. That's not what you did with this subcommittee's request.

Mr. GARTNER. Again, Mr. Chairman, Senator Stewart did not request any section 8 material, and specifically asked that he not be provided any section 8 material.

Mr. ROSENTHAL. But with regard to the request that this subcommittee had, you could have also brought any section 8 material back to the Commission for a separate vote.

Mr. GARTNER. The material that you requested was quite clear on its face and so we were able to vote at the time on the material you requested.

The decision to provide Senator Stewart with the information was voted 4 to 0 with the caveat that if there were any section 8 material that was included in the staff report, then the Commission would take a separate vote as to whether or not to delete that material.

Mr. ROSENTHAL. And the vote was 3 to 1?

Mr. GARTNER. That vote has not been taken because we have not yet received the information from the staff.

Mr. ROSENTHAL. The vote on the matter of producing material at this subcommittee's request was 3 to 1 on March 28, 1980.

Mr. GARTNER. Three to one not to provide you the information absent the subpena.

Mr. Chairman, I think it's probably appropriate at this time since this question has come up that I read into the record the majority viewpoint of the Commission with respect both to section 8 materials and with respect to exclusive jurisdiction, if you will permit me to do so.

This is a joint statement of Commissioner Dunn, Commissioner Martin, and myself.

In extensively amending the Commodity Exchange Act of 1974, Congress granted the Commission exclusive jurisdiction over futures trading. This was designed to avoid burdensome governmental regulation that would have resulted if futures trading were subject to duplicative regulatory requirements. At that time, Congress was fully aware that the proposals for futures trading in financial instruments and Government securities were being developed and was also well aware that the new Commission would have exclusive jurisdiction over those commodities which theretofore had not been the subject of Federal regulation, including the so-called world commodities, such as silver.

During 1978, when Congress conducted its Commission reauthorization hearings, Congress carefully reviewed the concerns expressed by the Department of Treasury, the Securities and Exchange Commission, the General Accounting Office and others. Each of these agencies, in varying degrees, suggested that the exclusive jurisdiction provision be modified. These agencies urged, for example, that a form of vertical integration of Federal regulation over futures markets be imposed; that any governmental agency that issues or has authority to investigate activities in the cash market of the commodity's underlying futures contracts also should have jurisdiction over the corresponding futures contract based on these commodities.

The position of a majority of the Commission today is the same as it was during the 1978 hearings. The Commission opposed then and continues to oppose now any intrusion into its exclusive jurisdiction.

Perhaps no better summary of the Commission's position exists than that set forth by the Senate Agriculture, Nutrition, and Forestry Committee in 1978. After reviewing the historical development of the futures markets, the proposals of those who would have changed the exclusive jurisdiction provision, and the Commission's performance between the years 1974 and 1978, that committee concluded that, "the basic conclusion reached in 1974 that there should be a single regulatory agency responsible for futures trading is as valid now as it was then."

The committee further stated, "No party concerned seriously alleges that any significant abuse exists in these futures markets, * * * or that regulation of the futures trading instrumentalities and processes involved should be shifted away from the CFTC."

And it stated further——

Mr. **Rosenthal**. Who's view is that?

Mr. **Gartner**. The Senate Agriculture Committee, sir, in 1978.

Mr. **Rosenthal**. Senate Agriculture Committee?

Mr. **Gartner**. Yes, sir. And it stated further, "the vesting of jurisdiction to regulate commodity futures trading in more than one agency would only lead to costly duplication and possible conflict of regulation or overregulation."

This is contained—all of these matters are contained in Senate Report No. 850 of the 95th Congress, second session.

Now, sir, with respect to confidentiality, the so-called section 8 material, continuing with the majority viewpoint of the Commission.

As you are aware, section 8 of the Commodity Exchange Act prevents the Commission generally from publishing data and information that would separately disclose the business transactions or market position of any person and trade secrets or names of customers. This provision traces its antecedents to the Futures Trading Act of 1921 and reflects a congressional determination of nearly 60 years standing that public disclosure by the Government of market information and trading data concerning the volatile futures markets should be discouraged.

Congress also has enacted certain exceptions to section 8. The Commission, like its predecessors, has interpreted these exceptions consistent with the underlying purpose of the provision—to maintain the confidentiality of sensitive market data. Thus, the Commission historically has determined only to disclose information where Congress has expressly so provided.

Congress has provided one such exception in connection with its oversight functions. Under section 8(e), when a committee of the Congress, acting within the scope of its jurisdiction, requests information from the Commission, the Commission is obliged to provide such information and would not hesitate to do so. In view of the purpose to be served by the confidentiality provision, however, a majority of the Commission continues to understand that if Congress had intended to permit subcommittees of committees to request this information from the Commission, Congress would have stated this explicitly. Moreover, the Commission has had its staff examine the legislative history of section 8, and there is no indication that Congress intended that the word "committee" in section 8(e) mean other than what it says.

Congress repeatedly has been made aware of the Commission's position, particularly during its extensive reauthorization hearings in 1978. At that time it was fully apprised of the Commission's interpretation of the confidentiality provisions of section 8, but it did not change the word "committee" to include a subcommittee. Therefore, the Commission sees no reason to depart from its interpretation of the law and believes that Congress, in fact, has implicitly approved that interpretation.

In contrast to section 8(e), the Commission does have discretion under section 8(b) of the act to provide sensitive information in connection with a congressional proceeding. Congress has thus clearly provided that when the Commission judges that it would serve some public purpose, the Commission may determine to disclose such information. It is the consensus of the Commission at this time that such discretion will be exercised only when the Commission perceives a compelling public interest to do so.

Mr. ROSENTHAL. The committee is adjourned.

[Whereupon, at 11:35 a.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

SILVER PRICES AND THE ADEQUACY OF FEDERAL ACTIONS IN THE MARKETPLACE, 1979-80

TUESDAY, APRIL 29, 1980

House of Representatives,
Commerce, Consumer,
and Monetary Affairs Subcommittee
of the Committee on Government Operations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Benjamin S. Rosenthal (chairman of the subcommittee) presiding.

Present: Representatives Benjamin S. Rosenthal, Robert T. Matsui, Eugene V. Atkinson, Elliott H. Levitas, Lyle Williams, and Joel Deckard.

Also present: Peter S. Barash, staff director; Barbara Timmer, counsel; Doris Faye Ballard, clerk; and Jack Shaw, minority professional staff, Committee on Government Operations.

Mr. Rosenthal. The subcommittee will be in order.

Today, the Commerce, Consumer, and Monetary Affairs Subcommittee continues its oversight into the adequacy of Federal response to events in the silver and related financial markets.

The Rules of the House of Representatives assign to the Government Operations Committee broad investigatory authority for the operation and activities of all Federal agencies and for the effectiveness of the laws they administer.

The committee is authorized to conduct investigations of any matter without regard to the jurisdiction of other standing committees; and it is mandated to make its investigatory findings and recommendations available to those committees.

When the Government Operations Committee held its organizational meeting for the 96th Congress, this subcommittee was assigned specific oversight jurisdiction for the operations, activities, and effectiveness of laws administered by the Commodity Futures Trading Commission, the Securities and Exchange Commission, the Federal banking agencies—including the Federal Reserve—and the Department of Treasury, including the IRS.

The regulatory responsibilities of each of these agencies have been seriously impacted by the recent collapse of the silver markets. When CFTC Chairman James Stone testified before the subcommittee recently he characterized this event as a situation of financial panic which could affect not only the commodities markets but the stock market and possible financial institutions as well.

This subcommittee has oversight responsibility for all the Federal agencies that supervise these farflung but interrelated financial markets.

Three days of subcommittee hearings have already indicated that the existing Federal regulatory apparatus is unable to anticipate and prevent the domino effect of the collapse of one market on another.

Our investigation requires the direct and detailed testimony from Nelson Bunker Hunt and William Herbert Hunt on the nature and extent of their silver trading activities and the financing of those activities; on their relationships with other larger traders and with commodity brokers, bankers, and securities dealers; on their use of foreign markets and exchanges; and on the regulatory and financial relief they sought directly from Federal officials.

On April 22, 1980, the subcommittee unanimously voted the issuance of a subpena directing Nelson Bunker Hunt and William Herbert Hunt to appear at today's hearing. The subpena has been executed and served.

It was authorized after Messrs. Hunt refused an April 7, written request to appear voluntarily before the subcommittee.

Only the testimony of these principals can provide the details necessary to our understanding of the operations of large commodity traders and the ability of existing laws and governmental structures to regulate their activities.

The subcommittee seeks answers to the following questions:

One, what events triggered the collapse of the silver markets in late March of this year?

Two, is the CFTC's surveillance of and response to speculative purchases of silver or other commodities by large traders, like the Hunts, adequate?

Three, is the CFTC's regulatory relationship with the commodities exchanges, here and abroad, adequate?

Four, will the collapse of a commodity market always have serious consequences on securities markets and dealers and on the banking community?

Five, what changes in the authority of the CFTC are necessary to prevent a recurrence of the silver market collapse?

Six, what structural or jurisdictional changes are desirable among the Federal agencies that supervise the various financial markets?

Seven, did the Hunt's communications with Federal regulatory officials or with officials of commodities exchanges influence events in the silver markets?

The failure of a subpenaed witness to appear before a legally constituted subcommittee of the U.S. Congress in pursuit of an authorized investigation, is an extremely serious offense for which there are a number of constitutional and statutory remedies.

Sections 192-194 of title 2 of the United States Code provides, in pertinent part, as follows:

> Section 192. Refusal of witness to testify or produce papers.
>
> Every person who having been summoned as a witness by the authority of either House of Congress to give testimony or to produce papers upon any matter under inquiry before either House, or any joint committee established by a joint or concurrent resolution of the two Houses of Congress, or any committee of either House of Congress, willfully makes default, or who, having appeared, refuses to

answer any question pertinent to the question under inquiry, shall be deemed guilty of a misdemeanor, punishable by a fine of not more than $1,000 nor less than $100 and imprisonment in a common jail for not less than one month nor more than twelve months.

I refer here to R.S. section 102; June 22, 1938, ch. 594, 52 Stat. 942.

Our first witnesses are representatives from the Department of Justice.

Would each of you please identify yourselves for the record?

STATEMENT OF THOMAS KLINE, CIVIL DIVISION, U.S. DEPARTMENT OF JUSTICE; ACCOMPANIED BY CLINT T. PEOPLES, U.S. MARSHAL, NORTHERN DISTRICT OF TEXAS

Mr. **Kline**. Good morning, Mr. Chairman, and members of the subcommittee.

I am Thomas Kline of the Civil Division of the Justice Department. With me today is Marshal Clint T. Peoples, U.S. marshal for the Northern District of Texas. He has held that post for 6 years.

Incidentally, this is Marshal Peoples' 50th year in law enforcement. Before being U.S. marshal for the Northern District of Texas, he was the chief of the Texas Rangers.

We have been asked to appear here today to explain the manner in which this subcommittee's subpenas were served on Nelson Bunker Hunt and William Herbert Hunt.

I would like to outline briefly the procedures we followed and then if the subcommittee so desires, Marshal Peoples can be sworn to testify about the detailed facts.

As you know, Mr. Chairman, as early as April 7, a telegram was sent to the Hunts requesting their testimony. That telegram requested their testimony for April 14.

On April 11, the Hunts' attorney responded by a letter requesting a delay in that appearance. On April 22, Tuesday of last week, this subcommittee authorized the issuance of subpenas to Nelson Bunker Hunt and William Herbert Hunt.

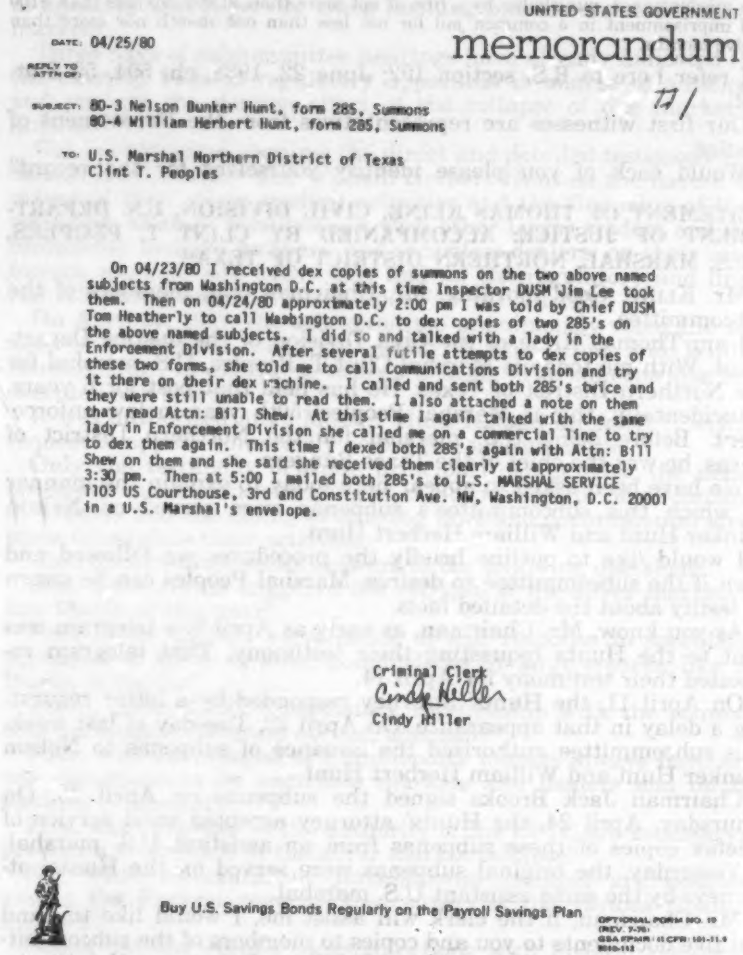
Chairman Jack Brooks signed the subpenas on April 23. On Thursday, April 24, the Hunts' attorney accepted valid service of telefax copies of these subpenas from an assistant U.S. marshal.

Yesterday, the original subpenas were served on the Hunts' attorneys by the same assistant U.S. marshal.

Mr. Chairman, if the clerk will assist me, I would like to hand out five documents to you and copies to members of the subcommittee which relate to the service of these subpenas on the Hunts.

Mr. **Rosenthal**. Without objection, all these documents shall be included in the record.

[The material follows:]



UNITED STATES GOVERNMENT

memorandum

TJ /

DATE: 04/25/80

REPLY TO ATTN OF:

SUBJECT: 80-3 Nelson Bunker Hunt, form 285, Summons
80-4 William Herbert Hunt, form 285, Summons

TO: U.S. Marshal Northern District of Texas
Clint T. Peoples

On 04/23/80 I received dex copies of summons on the two above named subjects from Washington D.C. at this time Inspector DUSM Jim Lee took them. Then on 04/24/80 approximately 2:00 pm I was told by Chief DUSM Tom Heatherly to call Washington D.C. to dex copies of two 285's on the above named subjects. I did so and talked with a lady in the Enforcement Division. After several futile attempts to dex copies of these two forms, she told me to call Communications Division and try it there on their dex machine. I called and sent both 285's twice and they were still unable to read them. I also attached a note on them that read Attn: Bill Shew. At this time I again talked with the same lady in Enforcement Division she called me on a commercial line to try to dex them again. This time I dexed both 285's again with Attn: Bill Shew on them and she said she received them clearly at approximately 3:30 pm. Then at 5:00 I mailed both 285's to U.S. MARSHAL SERVICE 1103 US Courthouse, 3rd and Constitution Ave. NW, Washington, D.C. 20001 in a U.S. Marshal's envelope.

Criminal Clerk
Cindy Hiller
Cindy Hiller

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

OPTIONAL FORM NO. 10
(REV. 7-76)
GSA FPMR (41 CFR) 101-11.6
5010-112

U.S. MARSHALS SERVICE PROCESS RECEIPT and RETURN

INSTRUCTIONS: See "INSTRUCTIONS FOR SERVICE OF PROCESS BY THE U.S. MARSHAL" on the reverse of the last (No. 5) copy of this form. Please type or print legibly, insuring readability of all copies. Do not detach any copies.

#2

PLAINTIFF	COURT CASE NUMBER
DEFENDANT	TYPE OF PROCESS

SERVE AT

NAME OF INDIVIDUAL, COMPANY, CORPORATION, ETC., TO SERVE OR DESCRIPTION OF PROPERTY TO SEIZE OR CONDEMN

ADDRESS (Street or RFD, Apartment No., City, State and ZIP Code)

SEND NOTICE OF SERVICE COPY TO REQUESTER AT NAME AND ADDRESS BELOW:

Number of process to be served with this Form-285

Number of parties to be served in this case

Check for service on U.S.A.

SPECIAL INSTRUCTIONS OR OTHER INFORMATION THAT WILL ASSIST IN EXPEDITING SERVICE (Include Business and Alternate Addresses, All Telephone Numbers, and Estimated Times Available For Service):

Fold

Fold

Signature of Attorney or other Originator requesting service on behalf of:	☐ PLAINTIFF ☐ DEFENDANT	TELEPHONE NUMBER	DATE

SPACE BELOW FOR USE OF U.S. MARSHAL ONLY — DO NOT WRITE BELOW THIS LINE

I acknowledge receipt for the total number of process indicated (Sign only first USM 285 if more than one USM 285 is submitted)	Total Process	District of Origin No	District to Serve	Signature of Authorized USMS Deputy or Clerk	Date

I hereby certify and return that I ☑ have personally served, ☐ have legal evidence of service, ☐ have executed as shown in "Remarks", the process described on the individual, company, corporation, etc., at the address shown above or on the individual, company, corporation, etc., shown at the address inserted below.

☐ I hereby certify and return that I am unable to locate the individual, company, corporation, etc., named above. (See remarks below)

Name and title of individual served (if not shown above): RODGER GOLDBERG, ATTORNEY DESIGNATED FOR SERVICE

☐ A person of suitable age and discretion then residing in the defendant's usual place of abode

Address (complete only if different than shown above):
3100 FIRST NAT'L BANK
DALLAS, TX

Date of Service: 9/29/80

Time: 7/ [✓ am] pm

Signature of U.S. Marshal or Deputy: RM Pazo

Service Fee	Total Mileage Charges (including endeavors)	Forwarding Fee	Total Charges	Advance Deposits	Amount owed to U.S. Marshal or	Amount of Refund (Check enclosed)
5			7			

REMARKS:

PRIOR EDITIONS MAY BE USED

2. USMS RECORD

FORM USM-285 (Rev. 11/11/77)

AFFIDAVIT OF SERVICE

STATE OF TEXAS

COUNTY OF DALLAS

Before me, the undersigned Notary Public in and for Dallas County, Texas, on this day personally appeared Norman Pope, Deputy United States Marshal for the Northern District of Texas, to me well known, and, after being duly sworn, upon his oath, and in the capacity stated, he did depose and say as follows:

I am a Deputy United States Marshal for the Northern District of Texas. Among my duties, I have been assigned to served two telefaxed congressional subpoenas issued by Jack Brooks, Chairman of the House Committee on Government Operations on April 23, 1980, to William Herbert Hunt and Nelson Bunker Hunt, received in our office at approximately 4:45 p.m. on April 23, 1980. The subpoenas summoned William Herbert Hunt and Nelson Bunker Hunt to appear before the House Subcommittee on Commerce, Consumer and Monetary Affairs of the Government Operations Committee on April 29, 1980, in Room 2154 of the Rayburn House Office Building at 10:00 a.m.

I served these subpoenas in the following manner: On the 24th day of April, 1980, I telephoned Lois Snow, Secretary to Nelson Bunker Hunt at Hunt Energy to arrange for service. She advised me that she would have Bart Cousins, attorney for the Hunts, call me. Mr. Cousins did call me shortly thereafter, and I advised him that I wanted to make arrangements to serve William Herbert Hunt and Nelson Bunker Hunt with the subpoenas. Mr. Cousins told me he would call me back; he called back to ask if the subpoenas were signed and by whom. I informed him that they were signed by Jack Brooks, whereupon Mr. Cousins said he would call me back. At approximately 10:30 a.m. I called Mr. Cousins and emphasized the importance of serving these subpoenas as soon as possible. At approximately 10:45 I received a telephone call from Mr. Cousins, advising me that he was still working on it. At approximately 11:15 a.m., Mr. Cousins called me and advised that Mr. Rodger Goldberg, an attorney in his firm, would accept service.

I therefore went to 3100 First National Bank Building in Dallas, Texas, to the law offices of Shank, Irwin, Conant, Williamson, and Gravele, and met with Mr. Cousins and Mr. Goldberg Mr. Goldberg agreed to accept service of the subpoenas on behalf of William Herbert Hunt and Nelson Bunker Hunt. I therefore served him with both subpoenas, as the attorney designated for service, at approximately 11:50 a.m. on April 24, 1980.

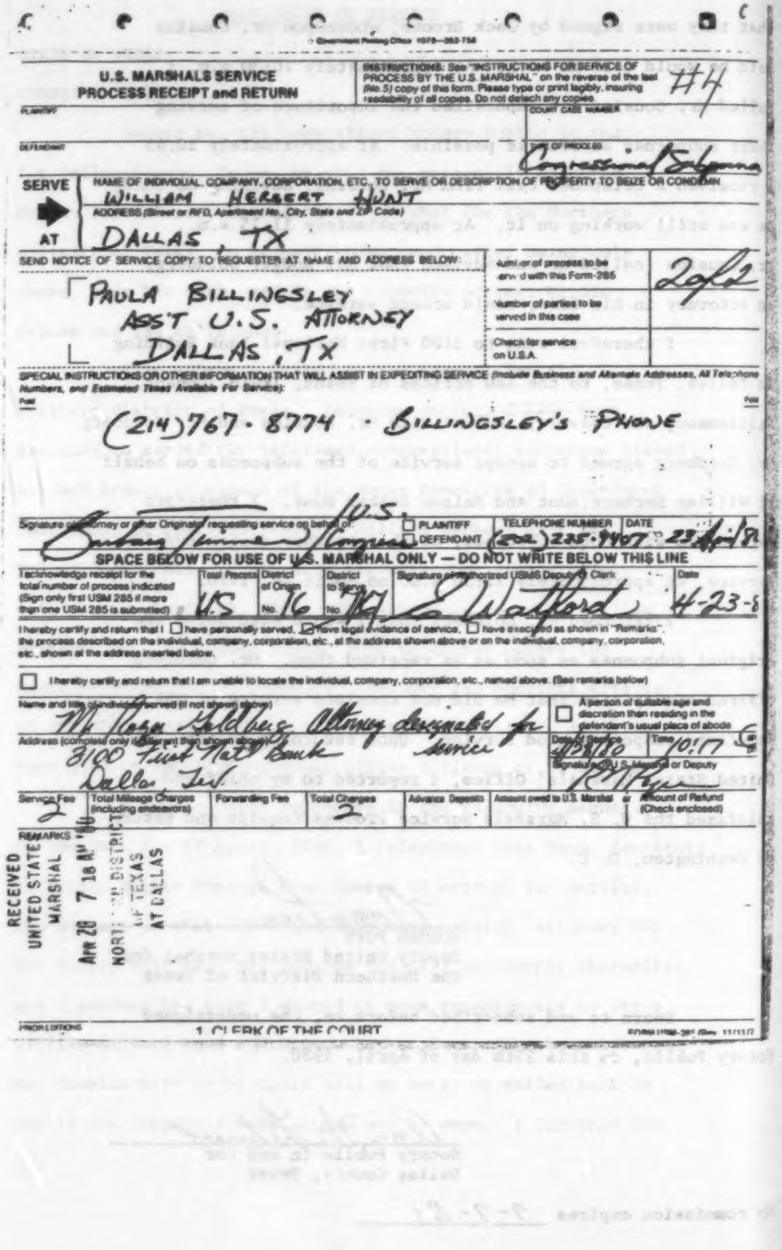
I informed Mr. Goldberg that I would also serve the original subpoenas as soon as we received them. Mr. Goldberg offered his opinion that he did not consider service of the telefaxed subpoenas good service. Upon returning to the United States Marshals' Office, I reported to my chief and telefaxed the U. S. Marshals Service Process Receipt and Return to Washington, D. C.

Norman Pope
NORMAN POPE
Deputy United States Marshal for
the Northern District of Texas

Sworn to and subscribed before me, the undersigned Notary Public, on this 25th day of April, 1980.

Ann W. Lehman
Notary Public in and for
Dallas County, Texas

My commission expires 7-7-81



☆ Government Printing Office 1979—283-756

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#4

PLAINTIFF

COURT CASE NUMBER

DEFENDANT

TYPE OF PROCESS: Congressional Subpoena

SERVE AT

NAME OF INDIVIDUAL, COMPANY, CORPORATION, ETC., TO SERVE OR DESCRIPTION OF PROPERTY TO SEIZE OR CONDEMN: WILLIAM HERBERT HUNT

ADDRESS (Street or RFD, Apartment No., City, State and ZIP Code): DALLAS, TX

SEND NOTICE OF SERVICE COPY TO REQUESTER AT NAME AND ADDRESS BELOW:

PAULA BILLINGSLEY
ASS'T U.S. ATTORNEY
DALLAS, TX

Number of process to be served with this Form-285: 2 of 2

Number of parties to be served in this case:

Check for service on U.S.A.

SPECIAL INSTRUCTIONS OR OTHER INFORMATION THAT WILL ASSIST IN EXPEDITING SERVICE (Include Business and Alternate Addresses, All Telephone Numbers, and Estimated Times Available For Service):

(214) 767-8774 - BILLINGSLEY'S PHONE

Signature of Attorney or other Originator requesting service on behalf of: Barbara Timmer U.S. Congress ☐ PLAINTIFF ☐ DEFENDANT

TELEPHONE NUMBER: (202) 225-9407

DATE: 23 Apr '80

SPACE BELOW FOR USE OF U.S. MARSHAL ONLY — DO NOT WRITE BELOW THIS LINE

I acknowledge receipt for the total number of process indicated (Sign only first USM 285 if more than one USM 285 is submitted)	Total Process US	District of Origin No. 76	District to Serve No. 79	Signature of Authorized USMS Deputy or Clerk E. Walford	Date 4-23-8

I hereby certify and return that I ☐ have personally served, ☑ have legal evidence of service, ☐ have executed as shown in "Remarks", the process described on the individual, company, corporation, etc., at the address shown above or on the individual, company, corporation, etc., shown at the address inserted below.

☐ I hereby certify and return that I am unable to locate the individual, company, corporation, etc., named above. (See remarks below)

Name and title of individual served (if not shown above): Ms Rozz Goldberg Attorney designated for service

☐ A person of suitable age and discretion then residing in the defendant's usual place of abode

Address (complete only if different than shown above): 3100 First Nat'l Bank, Dallas, Tex

Date of Service: 4/23/80

Time: 10:17 am

Signature of U.S. Marshal or Deputy

Service Fee	Total Mileage Charges (including endeavors)	Forwarding Fee	Total Charges	Advance Deposits	Amount owed to U.S. Marshal or Amount of Refund (Check enclosed)
2			2		

REMARKS

RECEIVED
UNITED STATE
MARSHAL
APR 28 7 18 AM '80
NORTHERN DISTRICT
OF TEXAS
AT DALLAS

PRIOR EDITIONS

1. CLERK OF THE COURT

FORM USM-285 (Rev. 11/11/7

AFFIDAVIT OF SERVICE

STATE OF TEXAS

COUNTY OF DALLAS

Before me, the undersigned Notary Public in and for Dallas County, Texas, on this day personally appeared Robert Norman Pope, Deputy United States Marshal for the Northern District of Texas, to me well known, and, after being duly sworn, upon his oath, and in the capacity stated, he did depose and say as follows:

#5

I am a Deputy United States Marshal for the Northern District of Texas. Among my duties, I have been assigned to serve two original congressional subpoenas issued by Jack Brooks, Chairman of the House Committee on Government Operations on April 23, 1980, to William Herbert Hunt and Nelson Bunker Hunt, received in our office on the morning of April 28, 1980. Exact, telefaxed copies of those subpoenas were served by me on April 24, 1980. To make arrangements for service of the originals, I called Mr. Roger Goldberg of the firm of Shank, Irwin & Connant at 8:35 a.m. today, April 28, 1980. He was not in yet, and I left word for him to return my call.

Having not heard from him by 9:35 a.m., I again called Mr. Goldberg and talked to him. I advised him that I had received the two original congressional subpoenas this morning. He asked if these were the orignals of the copies I served on him Thursday, April 24, 1980, and I replied that they were. He asked me to bring them over at my convenience, and he would accept service for the Hunts. He further stated that he would be in all morning. Approximately 9:38 a.m. I left my office to go to the 31st floor of the First National Bank Building, where Mr. Goldberg offices.

I arrived there at 9:53 a.m., and the receptionest recognized me and after my request to see Mr. Goldberg she called him. She then advised me that Mr. Goldberg was on the phone and would be with me shortly.

Approximately 10:08 a.m., a lady I recognized as Mr. Goldberg's secretary advised me that he was still on the phone, but should be through shortly.

Approximately 10:15 a.m. Mr. Goldberg came out. I advised him, that if possible I would like to serve both of the Hunts personally. He said that this was not possible and that in fact neither man was there at that time. He said that he would accept for them. I asked if he was accepting as their designated attorney for service, and he replied that he was. I then gave both original subpoenas to Mr. Goldberg at 10:17 a.m. this date.

Robert Norman Pope
ROBERT NORMAN POPE
Deputy United States Marshal for
the Northern District of Texas

Sworn to and subscribed before me, the undersigned Notary Public, on this 28th day of April, 1980.

Lynne Vener
Notary Public in and for Lynne Vener
Dallas County, Texas

My commission expires June 22, 1981

Mr. KLINE. I would like to identify the documents briefly.

The first are the notes of the clerk in Dallas who received transmission of the telefax copies of the subpenas.

The second document is the return of service signed by Assistant U.S. Marshal Norman Pope concerning service of the telefax copies of the subpenas.

The third document is an affidavit of service executed by Assistant U.S. Marshal Pope concerning the manner of service of the telefax copies of the subpenas.

The fourth document is a return or service, also signed by Assistant U.S. Marshal Pope, with the original subpenas.

The fifth document is Marshal Pope's affidavit of service concerning the manner in which he served the original subpenas on the Hunts' attorneys.

Mr. Chairman, if the subcommittee so desires, Marshal Peoples can now be sworn to testify in detail about the manner in which these subpenas were served.

Mr. ROSENTHAL. We will be happy to hear from you. Incidentally, we want to congratulate you on your 50 years of distinguished service in law service. We are very grateful to you for your appearance today.

Would you rise and be sworn in?

Do you solemnly swear that the testimony you are about to give this subcommittee is the truth, the whole truth, and nothing but the truth, so help you God?

Mr. PEOPLES. I do.

Mr. ROSENTHAL. Please identify yourself for the record.

Mr. PEOPLES. I am Clint Peoples, U.S. marshal from the Northern District of Texas, in Dallas, Tex.

Mr. ROSENTHAL. Would you like to tell us the details of the service or whatever information you can add to what Mr. Kline has already testified to?

Mr. PEOPLES. I would be glad to, Mr. Chairman.

On April 23, at approximately 2 p.m., I received a call from my national office, the U.S. marshal's office, stating that there would be a dex copy of the original subpena issued by this committee to be served upon the Hunt brothers.

We received that dex copy at approximately 4:45 p.m. on this particular day with the understanding that we would receive later the original, which would be sent in by express mail.

We did not receive it because it was sent in by regular mail. We received it the 28th.

But on the morning of April 24, I sent Deputy U.S. Marshal Norman Pope to serve the Hunt brothers. We called over, as we usually do, to make an appointment at the office. They were not in at the moment.

They told us that in a few minutes they would get together and make arrangements for the services to be effected.

A little later, about 10:30 a.m., I instructed my deputy to be certain to try to get hold of these people and expedite this situation as quickly as possible.

At approximately 11:30 a.m., we received a call that Mr. Roger Goldburg would receive the subpenas on behalf of the Hunt brothers.

Norman Pope went to the office of the Hunt brothers and effected the services at 11:50 a.m. on April 24, which was a Thursday.

I will refer to the second page of the document which we have given you concerning this service.

On April 28, Monday, at approximately 8:30 am., we received the original subpena through the U.S. mail. I asked Norman Pope to serve this original upon the Hunt brothers. I asked that we serve the subpenas in person, if at all possible.

Mr. Goldburg advised us that it would not be possible and they were not available, but he was the attorney designated to receive services for Nelson Bunker Hunt and William Herbert Hunt.

At this time we served the subpenas upon Mr. Roger Goldburg at 10:15 a.m., this concluded our service for the Hunt brothers.

Mr. **Rosenthal**. Is there anything else you want to add, Mr. Kline?

Mr. **Kline**. Mr. Chairman, I wanted to mention two additional things.

I understand counsel for the subcommittee spoke with the Hunts' attorney on April 15, requesting a date from the Hunts for them to come and testify.

I also understand that on April 22, the day the subpenas were issued, counsel for the subcommittee informed counsel for the Hunts that the subpenas had been issued. The text of the subpenas were read to the attorneys and they were told of the dates on which the Hunts were expected to appear.

Mr. **Peoples**. I have one other thing, Mr. Chairman.

Mr. **Rosenthal**. Please go ahead.

Mr. **Peoples**. This is the same type of procedure that we have used for many, many years for the Hunt brothers. [Laughter.]

They always accept service through their attorney. Very few times do we ever serve the Hunt brothers in person.

Mr. **Rosenthal**. Are they one of your better customers? [Laughter.]

Mr. **Peoples**. We do pay frequent visits over there.

Mr. **Rosenthal**. I have no questions.

Are there questions of other members of the subcommittee?

If not, we thank you both very, very much for appearing here this morning.

Mr. Atkinson?

Mr. **Atkinson**. In Pennsylvania there is a saying that nobody fools around with the Texas Rangers. So, I am sure that proper service was given and proper concern was given for the Hunts.

Mr. **Rosenthal**. Is Nelson Bunker Hunt or William Herbert Hunt present in this room?

Mr. **Goldburg**. Mr. Chairman?

Mr. **Rosenthal**. Are you representing them?

Mr. **Goldburg**. Yes, I am.

Mr. **Rosenthal**. Presumably they are not here.

Please come up and identify yourselves and tell us who you are.

STATEMENT OF ROGER GOLDBURG, ATTORNEY, SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE, DALLAS, TEX.; ACCOMPANIED BY PAUL L. PERITO, OF PERITO, DUERK, CARLSON & PINCO, WASHINGTON, D.C.

Mr. Goldburg. Good morning, Mr. Chairman.

My name is Roger Goldburg. I am a member of the firm of Shank, Irwin, Conant, Williamson & Grevelle.

Mr. Rosenthal. Please give us that again.

Mr. Goldburg. My name is Roger Goldburg. I am a member of the firm of Shank, Irwin, Conant, Williamson & Grevelle, 3100 First National Bank Building, Dallas, Tex.

Sitting with me at counsel table is Mr. Paul Perito, who is a member of the Washington Law firm of Perito, Duerk, Carlson & Pinco.

We appear here this morning on behalf of Nelson Bunker Hunt and William Herbert Hunt.

Mr. Rosenthal. Do you appear generally on their behalf?

Mr. Goldburg. Yes.

We appreciate the opportunity to address yourself and the members of your subcommittee.

Mr. Rosenthal. Would you tell us where your clients are and why they are not here and why you are here?

Mr. Goldburg. Yes, I will address myself to that during my statement, if I might have a brief moment to say something for the record in this regard.

Mr. Rosenthal. Please proceed.

Mr. Goldburg. There has been testimony this morning concerning acceptance of service of process of subpenas. I find the testimony to be accurate with one exception. That one exception is this.

The telecopy versions of the subpena were served in my office, my law offices, rather than in Mr. Hunt's office.

I should like to address the facts leading up to the issuance of these subpenas.

On April 7, we received a telegram from the chairman of this committee, and on April 11, we initiated contact on behalf of the Hunts, with the legal staff of this committee.

We also wrote a letter on April 11 to the legal staff, which in substance, indicated that we were faced with a number of inquiries by a number of governmental bodies, all of whom sought—indeed had already requested, in some cases—the Hunts to appear for their testimony in connection with the silver markets.

On April 18, we talked with counsel again, that is, counsel for the subcommittee and we indicated to her at that time that the Hunts had agreed, pursuant to a request of a subcommittee of the Senate Agriculture Committee, to appear on May 2, 1980, to give testimony in connection with substantially the same matters that this committee has sought with respect to its record.

We informed counsel that we were appearing on May 2 before the Senate subcommittee, and we asked counsel at that time to cooperate, if that was possible, with the Senate subcommittee so as to either ask various members of the Senate subcommittee to put questions concerning areas of inquiry which this committee had of concern, or alternatively, some measure of cooperation between Senate and House.

best copy available

That apparently was not met with favor. I understand on April 23 the Senate committee issued subpenas to my clients.

On April 24, we did indeed accept service of telecopy versions of a subpena issued to both Nelson Bunker Hunt and William Herbert Hunt.

Yesterday, we accepted service again of the original version of those subpenas which apparently had left Washington but did not arrive in time to make service last week.

So, the ultimate result is that 1 day before the scheduled appearance of the Hunts before this subcommittee, pursuant to the subpenas, that is service of those subpenas, was then effected.

In the meantime, sir, and I say this respectfully, on April 16 we received, Mr. Chairman, a request for an appearance before the subcommittee of the Senate to which I have previously alluded.

On April 17, my clients agreed to appear voluntarily and without subpena before that Senate subcommittee. That subcommittee has direct and primary jurisdiction over the commodities market, as I have pointed out in a document which I will allude in a moment.

So that the record is clear, sir, the Hunts have not failed to respond to this subpena. Rather, a motion to quash and vacate the subpena was timely filed with your committee on April 28, 1980. That was yesterday.

That motion to quash and vacate has been asked to be made a part of the record of this subcommittee.

Mr. ROSENTHAL. Without objection, that will be inserted in the record at this point.

[The material follows:]

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WILLIAM B. CHANEY
THOMAS I. HOSIER
JOHN T. HELM

April 28, 1980

The Honorable Jack Brooks
Chairman
Committee on Government Operations
U.S. House of Representatives
2157 Rayburn Office Building
Washington, D.C. 20515

The Honorable Benjamin S. Rosenthal
Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs
U.S. House of Representatives
B377 Rayburn Office Building
Washington, D.C. 20515

Dear Mr. Chairmen:

We are the attorneys for Nelson Bunker Hunt and William Herbert Hunt.

On April 24, 1980, this firm accepted service of telecopy versions of two subpoenas (the "Subpoenas") issued on April 23, 1980 by the Subcommittee on Commerce, Consumer, and Monetary Affairs of the United States House Government Operations Committee (the "House Subcommittee"). The Subpoenas, addressed to our clients and annexed hereto as Exhibit "A", demand that each appear to testify before the House Subcommittee on April 29, 1980 at 10:00 A.M. Testimony sought from our clients, according to the Subpoenas, is "in connection with the [S]ubcommittee's investigation of the operation of the silver markets. . . ."

We are authorized to respond to the Subpoenas on behalf of our clients. By this letter, we respectfully apply to the Government Operations Committee to vacate and quash each Subpoena. We further request that we be accorded a hearing before the full Committee to present to it the basis for this application.

In support of this Application, we respectfully direct your attention, for your evaluation and consideration, to the following matters:

1. Voluntary Agreement to Appear Before Senate Subcommittee. On April 16, 1980, the Subcommittee on Agricultural Research and General Legislation of the United States Senate Committee on Agriculture, Nutrition and Forestry (the "Senate Subcommittee") requested our clients, by way of a telegram,, to appear voluntarily before it to give testimony concerning the "silver futures market". A copy of this telegram to our clients from the Honorable Senator Donald W. Stewart, Chairman of the Senate Subcommittee, is annexed hereto as Exhibit "B". Contrary to any suggestion that our clients are disinclined to testify before Congress with respect to these matters, and cognizant of the primary legislative jurisdiction of the Senate Subcommittee over the matters to which the testimony sought pertains, each of our clients, one day following the Senate Subcommittee's request for their appearance, agreed to appear voluntarily before it on May 2, 1980. A copy of a letter to Senator Stewart confirming that agreement is annexed heretq a Exhibit "C".

2. Primary Jurisdiction of the Senate Subcommittee. Primary legislative jurisdiction over the commodities markets is vested in the Senate Committee on Agriculture, of which the Senate Subcommittee before which our clients will appear is a part. The Senate Agriculture Committee was the architect of the Commodities Futures Trading Commission Act of 1974. This legislation amended the Commodity Exchange Act in significant respects, including the establishment of the Commodities Futures Trading Commission. The Futures Trading Act of 1978, implemented again by the work of the Senate Committee on Agriculture, also addresses itself to matters

upon which our clients are called to provide testimony. Indeed, the House Committee on Agriculture[1] cooperated with the Senate Committee to make significant contributions to the passage of the Futures Trading Act of 1978. We submit that the willingness of our respective clients to appear voluntarily before the Senate Committee of the Congress vested with primary legislative jurisdiction over commodities trading matters adequately fulfills their responsibility to furnish testimony to Congress.

3. Cooperation between House and Senate. One day following our clients' agreement to appear voluntarily before the Senate Subcommittee, we contacted staff counsel for the House Subcommittee. We advised counsel of the intention of each of our clients to appear and to testify voluntarily before the Senate Subcommittee. We further suggested that the House Subcommittee coordinate with the Senate Subcommittee to facilitate an orderly and efficient presentation of our clients' testimony. We likewise suggested that members of the Senate Subcommittee inquire of our clients concerning those matters that members of the House Subcommittee desired to explore, provided that such matters were relevant to this inquiry. Those suggestions were not met with favor. Subpoenas thereafter issued from the House Subcommittee, returnable on April 29, 1980. At the time of their issuance, all parties in interest were certainly aware that our clients were appearing before a Senate Subcommittee voluntarily to testify as to the silver futures market only three days later.

4. Comity and Fundamental Fairness. Our clients urge that they not be subject to an environment of competition for their testimony. They recognize and fully appreciate the responsibilities of concerned legislators, both in the House and Senate. But they nevertheless suggest for your consideration the attendant consequences of multiple hearings, including duplication of testimony and expenditure of extraordinary effort, time and resources both on the part of Congressmen and of citizens. In addition, other Committees of Congress are also interested in the matters about which our clients will (and welcome the opportunity to) testify

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[1] As you know, primary legislative jurisdiction over "commodities exchanges" in the House of Representatives is vested in the House Committee on Agriculture. See Rule X(a) of the Rules of House of Representatives.

before the Senate Subcommittee. In light of our clients' anticipated appearance before the Senate Subcommittee on May 2, 1980, we urge that as a matter of comity, unity of effort and, indeed, fundamental fairness to all parties, the Subpoenas be vacated and quashed.

It is not without precedent that Committees of the House have delayed legislative inquiry because of reasons of fundamental fairness. In this regard, Mr. Justice Brennan, in a concurring opinion in Hutchinson v. United States, 369 U.S. 599, 625 (1962), stated that "even within the realm of relevant [House or Senate] inquiry, there may be situations in which fundamental fairness would demand a postponement of inquiry until after an immediate pending trial, or in the taking of testimony in executive session. . ." Although the Court's opinion in Hutchinson was rendered in a context where there was a pending state proceeding which paralleled the inquiry of a legislative committee, it is clear from the underlying judicial reasoning that the public interests in legitimate legislative inquiry are not abridged by a delay or a postponement of such inquiry when counterveiling issues of fundamental fairness to witnesses are involved. It is respectfully suggested that no prejudice will result to the Government Operations Committee and/or the House Subcommittee if the instant Subpoenas are vacated so that our clients will have an opportunity to complete, in an orderly fashion, their testimony before the Senate Subcommittee and, at the same time, attend to, in a responsible manner, various Executive agency demands for information. Given the circumstances, the vacating of the Subpoenas will be in the time-honored spirit of cooperativeness and comity between the House and Senate.

5. Willingness to Appear Before the House of Representatives. We are not suggesting, nor have we ever suggested in our discussions with House and Senate Staff Counsel, that the respective Committees of the House and Senate do not have the power to conduct investigations, inter alia, into the operation of the silver markets for legitimate legislative purposes. However, we respectfully suggest that such power is not unlimited. See Watkins v. United States, 354 U.S. 178 (1957); Kilborne v. Thompson, 103 U.S. 168 (1881). Further, we are in no way suggesting that the purpose of the House Subcommittee's inquiry is buttressed by anything other

than a legitimate desire to evaluate and/or to oversee the proper operation of Executive offices, agencies and commissions within the House Subcommittee's jurisdiction. However, we respectfully contend that such legislative inquiry be juxtaposed and balanced against the effects that compelled testimony will have upon our clients, particularly at this juncture and in this proposed time sequence.

We do not mean to imply by this application that our clients are unwilling to appear before a Committee or Subcommittee of the House of Representatives in connection with these matters. Rather, in order to achieve proper harmony between competing Congressional and Executive interests, it is submitted that additional time is needed so that our clients can complete, in an orderly and responsible fashion, their scheduled testimony before the Senate and so that they may respond to certain Executive agency requests. We understand that the House Banking Committee and the House Agriculture Committee will hold hearings looking into recent events in the silver market. Various Senate Committees (other than Senator Stewart's Senate Subcommittee) intend to convene hearings on these matters. Accordingly, given the multiplicity of Congressional inquiries and Executive agency requests for information, our clients' request, and, indeed, are entitled to, an orderly, efficient and properly coordinated presentation of their testimony. That is, after all, one of the major premises upon which our application to vacate and quash the Subpoenas rests.

With deference, we respectfully ask that the Government Operations Committee set a hearing at a time mutually convenient to all parties to permit a detailed exposition of the merits of this application to vacate and quash the Subpoenas and to permit counsel to respond to any inquiries of Members of the full Committee relating to the instant application. We also respectfully request that this letter application be placed in, and made a part of, the permanent records of your respective Committees.

Respectfully submitted,

Roger Goldberg

Roger Goldberg

RG:hm

cc: The Honorable Frank Horton
The Honorable Lyle Williams

Mr. GOLDBURG. Contrary to any suggestions on this record, and contrary to any indications which might be drawn from a failure or from Mr. Hunt's nonappearance here today, we have filed in good faith a motion to quash the subpenas with the party and the body that has issued the subpenas, rather than approaching a court to do the same.

The motion to quash recognizes the authority of this House Government Operations Committee. It does not in any way depreciate the authority of this committee to conduct its inquiry.

The motion to quash points out that my clients are subject to a multiple of inquiries by a variety of governmental bodies. Included in those parties which seek information from them concerning the silver markets are executive agencies of the U.S. Government, Senate congressional committees, House congressional committees—other than yours—and, indeed, potential litigation which may be spawned by reason of recent events in the silver market.

In substance, Mr. Chairman, these are parallel demands for, in large part, sir, they seek mostly the same information.

We have reason to believe, as we pointed out as early as April 11 to your staff counsel that the Banking Committee, the Agriculture Committee, and, indeed, your committee were not the only committees which were calling our clients to testify.

We have asked, as a basic matter of fundamental fairness, and to the extent that falls under the umbrella of due process, that these various inquiries become coordinated so that our clients have an opportunity to respond in an effective, efficient, and orderly fashion.

We have, as pointed out previously, not challenged the right of this subcommittee to summon our clients in the court. We have brought to your attention, rather, through an operation of fundamental fairness to our clients, our motion to quash.

Messrs. Hunt have no desire to be consternating to this committee and they have no desire to be disrespectful to this committee. They are, however, sir, entitled to fundamental fairness in terms of an orderly presentation in the scheduling of their testimony.

The motion to quash and vacate these subpenas were filed as soon as humanly possible, in addition to which they take into account that my clients are prepared to appear, and will so appear, on Friday, May 2, before Senator Stewart's subcommittee in the Senate.

We do not feel, in any respect, that our client should be caught up in a competition for their testimony. We recognize the right of this body to inquiry of our clients, provided such inquires are relevant. We recognize the right of the Senate to do so.

We have pointed out in our motion to quash, in as lawyer-like a fashion as we can, that in the interest of commodity, our client's appearances before various governmental bodies be scheduled so that an orderly presentation can be made.

We have also pointed out, Mr. Chairman, our clients' willingness to appear before House congressional subcommittees. They have not taken the position, nor do they intend to take the position, that they will not furnish testimony to congressional committees of the House, provided those committees have appropriate jurisdiction and provided their appearances are scheduled in some way, at least, to accommodate their needs as well as the legislators' needs.

Yesterday, Mr. Chairman, in response to our motion to quash or vacate these subpenas, we received the committee's response, apparently through your telegram to us, wherein you have indicated that our motion to quash was denied in all respects.

I have not seen the original of that telegram. I do not know the circumstances under which the telegram was issued.

We appreciate your concern, Mr. Chairman, with your inquiry and with your subcommittee's inquiry, into the silver markets, but, on the other hand, we do feel that our clients are entitled to an appropriate scheduling of their testimony so that they can conduct their lives without having to become, indeed, what I would characterize as professional witnesses in connection with these matters over the next 6 months.

It is recognized that they will have to testify, and they will do so, to the extent that those inquires are valid.

We do not represent people who have been charged, nor is there any reason to believe that there is anything for which they may be charged with wrongdoing. They welcome the opportunity to testify, provided again, sir, it is an orderly presentation of that testimony.

We would ask and commend to your basic judgment a balancing between the rights of our clients and the rights of this committee to secure testimony. Our clients are prepared to appear before this committee but not at this time. I have indicated this previously. We are not suggesting, by virtue of our position, that we are unwilling to come to this hearing room for purposes of appearing before this committee. All we want is a reasonable scheduling. I appreciate the opportunity to address you, Mr. Chairman, and I appreciate your courtesy.

Mr. **Rosenthal.** Before I comment, could you tell us specifically, so that I understand it, what is your request on behalf of your clients?

Mr. **Goldburg.** My request, sir, is to have my clients come to testify before this hearing at a time which will be consistent with the schedules of this committee, as well as the schedules of my clients, which I am sure, based upon what you have read in the press, is quite extraordinary, as is, I might add, that of counsel.

Mr. **Rosenthal.** Why are they not here today?

Mr. **Goldburg.** Because, sir, they took the position that orderly presentation of evidence is important to their basic business conduct as well as to the overall inquiry into these matters.

Mr. **Rosenthal.** Have you read the statute concerning contempt of Congress?

Mr. **Goldburg.** Yes, I have.

Mr. **Rosenthal.** Have you advised your clients as to whether or not they would be in contempt of Congress if they failed to show up here this morning?

Mr. **Goldburg.** Given the filing of this motion, sir—I was going to refer to you as Your Honor, but I will refer to you as Your Chairman.

Mr. **Rosenthal.** You will have a chance to say that before someone else, I suspect. [Laughter.]

Mr. GOLDBURG. Given the filing of this motion to quash, I, for one, am not concerned they are contumacious in response to your committee.

Mr. ROSENTHAL. Did you tell them they should not come here today?

Mr. GOLDBURG. No, sir. I advised them, as I must do, in the best professional interest of my client. What I told them would be privileged.

Mr. ROSENTHAL. Yes, you are correct.

Let me comment on some of the facts and your argument. I say this not in any personal way, but I think your argument and presentation is both illogical and frankly, impertinent.

Your letter, which you describe as a motion to quash the subpena, was dated April 28, 1980, and was received by the subcommittee staff at 4:30 p.m. yesterday afternoon.

To describe this letter or its request as a motion to quash, is an absurdity. I am absolutely astounded that a lawyer of distinction such as yourself, Mr. Goldburg, would have the temerity to make that kind of a presentation.

Any first-year law student could look at this letter and no one could describe it as a motion to quash. It is a letter telling us that you are the attorneys for Nelson Bunker Hunt and William Herbert Hunt. You comment on a number of points.

No. 1 is voluntary agreement to appear before the Senate; two, primary jurisdiction in the Senate by the Senate subcommittee.

You suggest in both those points that because they are voluntarily appearing before the Senate subcommittee that we ought not to continue our work and should defer to the Senate subcommittee.

And, as a matter of fact, during the course of your oral presentation today, you even suggested that we submit questions for the Senators to ask. I can only assume that you are unfamiliar with the way this institution works. Both Houses of the Congress maintain their own integrity and have their own responsibilities.

Also, you talk about the cooperating between the House and Senate. Then you talk about commity and fundamental fairness.

You in no way ask for an adjournment to a particular date. You do not say that the Hunts are sick. You say that you are very busy and they are very busy and that they have other business to talk about and other committees to visit.

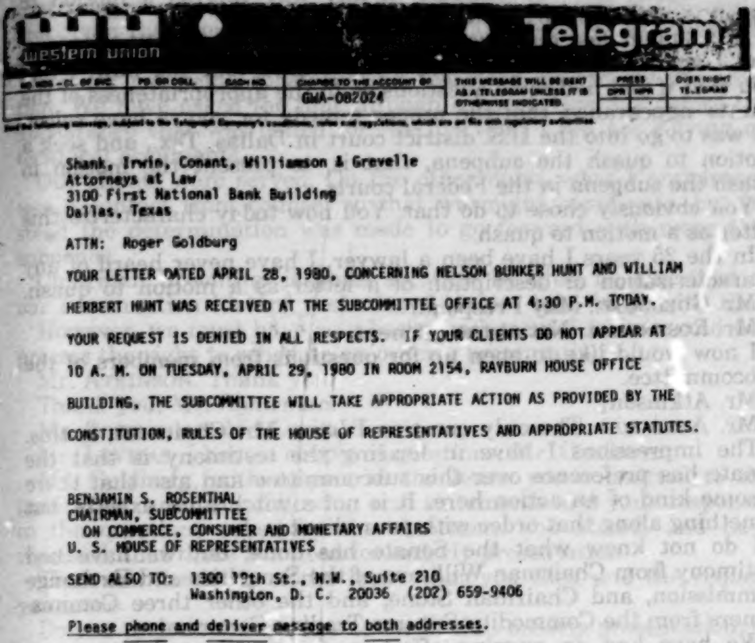
As I said earlier, this letter was received at 4:30 p.m. yesterday afternoon. At 4:45 p.m. yesterday, I sent you the following telegram:

> Your letter dated April 28, 1980, concerning Nelson Bunker Hunt and William Herbert Hunt was received at the subcommittee office at 4:30 p.m. today. Your request is denied in all respects.
>
> If your clients do not appear at 10 a.m. on Tuesday, April 29, 1980, in room 2154, Rayburn House Office Building, the subcommittee will take appropriate action as provided by the Constitution, Rules of the House of Representatives, and appropriate statutes.

At 4:45 p.m. I called your office in Texas. You were busy on a conference call. I left my offfice at 5:15 p.m., and I am told at 5:30 p.m. you called my office. My secretary read this telegram to you.

Without objection, your letter and my telegram will be inserted in the record.

[The letter dated April 28, 1980, referred to may be found on page 189. The telegram dated May 28, 1980, follows:]



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Telegram

NO. WDS.–CL. OF SVC.	PD. OR COLL.	CASH NO.	CHARGE TO THE ACCOUNT OF	THIS MESSAGE WILL BE SENT AS A TELEGRAM UNLESS IT IS OTHERWISE INDICATED.	PRESS DPR	PRESS NPR	OVER NIGHT TELEGRAM
			GWA-082024				

Send the following message, subject to the Telegraph Company's conditions, rules and regulations, which are on file with regulatory authorities.

Shank, Irwin, Conant, Williamson & Grevelle
Attorneys at Law
3100 First National Bank Building
Dallas, Texas

ATTN: Roger Goldburg

YOUR LETTER DATED APRIL 28, 1980, CONCERNING NELSON BUNKER HUNT AND WILLIAM HERBERT HUNT WAS RECEIVED AT THE SUBCOMMITTEE OFFICE AT 4:30 P.M. TODAY. YOUR REQUEST IS DENIED IN ALL RESPECTS. IF YOUR CLIENTS DO NOT APPEAR AT 10 A. M. ON TUESDAY, APRIL 29, 1980 IN ROOM 2154, RAYBURN HOUSE OFFICE BUILDING, THE SUBCOMMITTEE WILL TAKE APPROPRIATE ACTION AS PROVIDED BY THE CONSTITUTION, RULES OF THE HOUSE OF REPRESENTATIVES AND APPROPRIATE STATUTES.

BENJAMIN S. ROSENTHAL
CHAIRMAN, SUBCOMMITTEE
ON COMMERCE, CONSUMER AND MONETARY AFFAIRS
U. S. HOUSE OF REPRESENTATIVES

SEND ALSO TO: 1300 19th St., N.W., Suite 210
Washington, D. C. 20036 (202) 659-9406

Please phone and deliver message to both addresses.

Mr. ROSENTHAL. To describe in any way this as a motion to quash is, as I said earlier, an absurdity.

At 9:30 p.m. last night you called me at my home in Washington, and I again restated essentially what I have told you now. I told you that if you had some questions as to the appropriateness of the Hunts' appearance, that the proper remedy for you to have selected was to go into the U.S. district court in Dallas, Tex., and seek a motion to quash the subpena, that is, to present the motion to quash the subpena in the Federal courts.

You obviously chose to do that. You now today characterize this letter as a motion to quash.

In the 25 years I have been a lawyer, I have never heard of any characterization or description of a letter as a motion to quash.

Mr. GOLDBURG. May I respond?

Mr. ROSENTHAL. Not at the moment.

I now would like to open up for questions from members of the subcommittee.

Mr. Atkinson?

Mr. ATKINSON. The only question I have, Mr. Chairman, is this.

The impressions I have in hearing the testimony is that the Senate has preference over this subcommittee and also that there is some kind of an action here. It is not a witch hunt exactly, but something along that order with your client.

I do not know what the Senate has done, but we have had testimony from Chairman Williams of the Securities and Exchange Commission, and Chairman Stone, and the other three Commissioners from the Commodity Futures Trading Commission.

We have had an ongoing effort so far as silver dealings are concerned.

I just wanted to make that point. This House has been actively involved. It seems as though you have a preference to go to the Senate side as opposed to the House side.

I was wondering if that was a true evaluation.

Mr. GOLDBURG. May I address Representative Atkinson?

Mr. ROSENTHAL. Go right ahead.

Mr. GOLDBURG. There is no preference on our part in any respect, nor do we mean to imply any such preference. The fact that your inquiry has preceded, or the commencement date of your inquiry had preceded the Senate Agriculture Committee's inquiry, did not occur to me as a relevant factor as to who or what body our clients should appear before first.

I might add that before cohesive and coherent and cogent testimony is given, that perhaps the chairman does not like my piece of paper that I filed with him.

But on the other hand I do know that one needs to prepare his client for testimony.

It is an extraordinary burden. To do that, we must have control, at least to some extent, and coordination with those bodies who wish to have our client's testimony.

We intend no disrespect.

I would like to comment on the fact that the reason we filed our motion—and I characterize it as a motion—is that it is an application to this committee so that this committee can evaluate the needs of this committee for our clients' testimony with the burdens that they, as well, face, given the enormous interest of the media and given the enormous interest of various executive agencies into events in the silver markets.

We are not being consternating. We need an orderly presentation. We have asked for that through counsel. One day before the appearance that was called for, we did that. I am not relying on technical arguments.

Our clients were served. On the other hand, what I anticipated was a contact from counsel so that we might coordinate, but instead the determination was made to go forward with respect to subpenas.

Chairman Rosenthal is quite accurate in what he described as our conversation history yesterday. I do not take issue with that.

However, we must have as a basic fundamental fairness and due process the right to schedule an orderly presentation.

Mr. **Atkinson**. Thank you.

Thank you, Mr. Chairman.

Mr. **Rosenthal**. Mr. Levitas?

Mr. **Levitas**. I have a couple of questions, Mr. Chairman.

Mr. Goldburg, with respect to the letter you submitted to the committee, and your following oral statements and your responses to the questions asked by the chairman, you stated, and have repeated, that there is a need for orderly presentation.

That was the basis of the letter that you filed and the request you made.

Do you understand the law to mean that orderly presentation, or the need for it, is any grounds for a witness, properly subpenaed, not to appear before a committee of the Congress?

Mr. **Goldburg**. Representative Levitas, an orderly presentation was not—and I say this respectfully—the only underpinning for our application to this committee.

I must return the committee's attention, if I might, to due process and to fundamental fairness to our client with respect to being hither and yon, which they are prepared to go hither and yon.

However, the problem is that in facing a compelled testimony concept, they face a far difficult and more difficult situation, as do we, as attorneys, in terms of ferreting our way through these matters to the satisfaction of everybody.

Nobody is going to be satisfied if our clients do not appear on a given day. Some may because we have adhered to their particular schedule. We mean no disrespect. Our clients have a story to tell, which they want to tell, as well, with respect to these matters.

I commend that as a consideration.

I do believe that due process constitutes, in some respects, a reasonable basis upon which to quash a subpena. It constitutes a cloak, assuming the motion is timely filed, to permit to conclude that they are not being contemptuous of this august body.

Mr. **Levitas**. I suggest, Mr. Goldburg, you have not answered my question. My question was this: Do you believe, or is it your legal position, that orderly presentation, or the desire for orderly presentation, as determined by you or your clients, is a basis for your clients not appearing in response to the subpenas?

Mr. **Goldburg.** To the extent that an orderly and efficient and coordinated presentation is a part of due process, and fundamental fairness, I think my answer to that is "Yes."

Mr. **Levitas.** You do think that; right?

Mr. **Goldburg.** Yes.

Mr. **Levitas.** Do you have a citation or any case or precedent that would support that position?

Mr. **Goldburg.** I do and can give you authority to the effect, particularily the *Bergland* case which would support this.

Mr. **Levitas.** While you are looking for that, let me say this. I might suggest to you that as I read page 3, paragraph 3, of your letter, the words, "due process" do not appear at any point.

Mr. **Goldburg.** The point is this. I would like to respond to that. Fundamental fairness, rises, in some instances, as it does in this, to the level of due process.

Mr. **Levitas.** So far as timeliness is concerned, and shortness of opportunity to properly prepare, and the fact that the subpena was issued around April 23, let me say this.

Am I correct that your clients were first invited to appear before this subcommittee by telegram on April 7?

Mr. **Goldburg.** Yes.

Mr. **Levitas.** So, there is no question that at least at that date they were aware, not only of the desire for this committee to hear from them, but subsequently were told the subject matters that this committee wanted to inquire into; right?

Mr. **Goldburg.** The telegram from Chairman Rosenthal indicated the subject matter to which inquiry was to be posed.

I should also add in that connection that my clients have never, either for the record, or informally with counsel, suggested that they would not appear before your subcommittee.

Mr. **Levitas.** But they did not respond to this subpena. They were certainly not taken by surprise. They knew what the subject matter was. They were invited to testify.

Subpenas were issued, and the response is that they are not here.

Mr. **Goldburg.** Their response was that they are not unwilling to come here, but under the circumstances, at some point in time, my clients had to take a position with respect to a multiplicity of inquiries.

I say that respectfully.

Mr. **Levitas.** And what you are telling me is that they chose to appear voluntarily before another committee that, subsequent to our involvement, got involved, rather than responding to the legal process requiring their appearance here today.

Mr. **Goldburg.** They chose to appear on May 2 because counsel got started on the dialog with respect to the logistics of that appearance. We never—and I sound like a broken record, I suppose, but I must underscore this—refused to voluntarily appear before this subcommittee.

It is a matter of scheduling and a matter which must be urged on behalf of our clients, not necessarily in singling out this particular committee, but in order that we take a position to have an orderly presentation in the future.

As I understand it, Senator Proxmire's committee and other Representatives want our clients' testimony. It is an enormous burden on them. It is an enormous burden on counsel. It is an enormous burden on Representatives.

We are not taking the position that our clients will not appear before this committee.

All we want is a reasonable scheduling of that appearance.

Mr. **Levitas**. I suggest to you, Mr. Goldburg, that there is an amazing inconsistency in what is being said and what is occurring.

It seems to me like your clients have arrogated to themselves the decision to do what they want to do rather than to do what I believe the law requires them to do, which is to respond to a subpena.

What we have here is this. They were originally asked to appear voluntarily. They did not. Subpenas were issued. That was no longer a voluntary appearance. They chose not to obey those subpenas.

They decided instead to make a voluntary appearance before another committee.

I suggest to you there is some obvious inference to be drawn from that, quite apart from what I consider to be a contempt, a treatment of contempt for the subcommittee and for the Congress. It is a very contumacious way.

Mr. Chairman, I find it totally intolerable and unacceptable.

Mr. **Rosenthal**. Mr. Williams?

Mr. **Williams**. I have one question. Did you ever communicate to this subcommittee that your clients were willing to respond?

You mentioned some concerns about the media and the attention your clients are getting. It seems to me that a much better way to have handled this would have been to respond to the subpena.

Mr. **Goldburg**. May I respond?

Mr. **Rosenthal**. Certainly.

Mr. **Goldburg**. We have communciated with counsel, and we have communicated by letter indicating that we are prepared to cooperate with respect to appearing.

Mr. **Williams**. Did not your letter say "cooperate with the Senate" instead of cooperating with this subcommittee?

Mr. **Goldburg**. May I respectfully refer your attention to this? I would like a moment to get out a letter.

Mr. **Rosenthal**. Let me announce that tomorrow morning at 10 a.m., Chairman Volcker and the Comptroller of the Currency, John Heimann, are voluntarily appearing before the subcommittee.

Mr. **Williams**. You asked us to cooperate with the Senate, I think by your letter.

Mr. **Goldburg**. Let me respectfully refer your attention to our letter of April 11. I would like to read it into the record.

The second paragraph says:

> As I have previously explained to Ms. Timmer, it is virtually impossible for our clients to evaluate your request and to prepare properly for any such appearance on the limited notice afforded by the telegram.

Indeed, we offered in that same letter that we would be back to the committee through counsel to discuss an appropriate date for such appearance.

Mr. **Rosenthal**. Mr. Matsui?

Mr. **Matsui**. Mr. Goldburg, your letter of April 11—I suppose you are referring to the last paragraph of that letter wherein you said:

"I have therefore advised Ms. Timmer that I shall contact her early next week to discuss a potential date for such appearance."

Is that correct?

Mr. GOLDBURG. That is right.

Mr. MATSUI. You are not under oath, but I am assuming that you are prepared to place yourself under oath.

Will you tell me whether you contacted her early last week, or Friday of last week?

Mr. GOLDBURG. Friday of the following week.

Mr. MATSUI. Did you not tell her at that time that you expected this subcommittee and her to cooperate with you and that you had decided to go on the Senate side to the Senate Agriculture Committee and that you offered her no date?

Mr. GOLDBURG. I told her the following: That we had voluntarily agreed to appear before the Senate subcommittee and that, further, we would appreciate it if "your committee could cooperate in some way with the Senate subcommittee."

Mr. MATSUI. Go ahead.

Mr. GOLDBURG. She asked me whether my clients intended to appear at some point.

I said that they would like some cooperation. They wanted to cooperate with her so that we could avoid duplicative appearances.

Mr. MATSUI. I would conclude by saying this. Not only does your so-called motion to quash have no legal precedent and is contemptuous, but also your attempt to deceive the subcommittee with this particular letter and that statement your made prior to my intervening, is deceitful, I think.

Mr. GOLDBURG. I have no intention to deceive. It has been my position, and would continue to be my position, that our clients have not refused to cooperate and appear voluntarily before this committee.

Mr. MATSUI. I have no further questions.

Mr. ROSENTHAL. Mr. Deckard?

Mr. DECKARD. Counsel for the Hunts seems to be saying that his clients' appearance before a subcommittee of the other body somehow releases them of any necessity to appear before a subcommittee of the U.S. House of Representatives, article I, section 1 of the Constitution notwithstanding.

Counsel has said that the Senate Agriculture Committee is the proper forum. And, yet, as the chairman has already stated, this subcommittee is the only one in Congress having direct jurisdiction over all the Federal agencies, including the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Treasury Department, Federal Reserve, Commerce, and the Federal Trade Commission.

Therefore, Mr. Chairman, I think the followng contempt motion is in order. I wish to officially bring it before the subcommittee.

Mr. Chairman, I move that the subcommittee recommend to the full Government Operations Committee that a resolution of contempt be issued by the committee against Nelson Bunker Hunt and William Herbert Hunt and that it be reported to the House of Representatives for a vote thereon.

Mr. ROSENTHAL. The clerk will call the roll.

Mr. **Levitas**. So the record can be correct on this, Mr. Chairman, I would like to second that motion.

Mr. **Rosenthal**. Thank you. It is seconded.

The clerk will call the roll.

The **Clerk**. Mr. Rosenthal?

Mr. **Rosenthal**. Aye.

The **Clerk**. Mr. Matsui?

Mr. **Matsui**. Aye.

The **Clerk**. Mr. Atkinson?

Mr. **Atkinson**. Aye.

The **Clerk**. Mr. St Germain?

[No response.]

The **Clerk**. Mr. Conyers?

[No response.]

The **Clerk**. Mr. Levitas?

Mr. **Levitas**. Aye.

The **Clerk**. Mr. Williams?

Mr. **Williams**. Aye.

The **Clerk**. Mr. Jeffries?

[No response.]

The **Clerk**. Mr. Deckard?

Mr. **Deckard**. Aye.

Mr. **Rosenthal**. The clerk will announce the results.

The **Clerk**. There are six ayes and no nays.

Mr. **Rosenthal**. The motion is carried.

The subcommittee stands adjourned.

[Whereupon, at 10:55 a.m., the subcommittee adjourned, to reconvene at 10 a.m., Wednesday, April 30, 1980.]

SILVER PRICES AND THE ADEQUACY OF FEDERAL ACTIONS IN THE MARKETPLACE, 1979–80

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WEDNESDAY, APRIL 30, 1980

House of Representatives,
Commerce, Consumer,
and Monetary Affairs Subcommittee
of the Committee on Government Operations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Benjamin S. Rosenthal (chairman of the subcommittee) presiding.

Present: Representatives Benjamin S. Rosenthal, Fernand J. St Germain, Elliott H. Levitas, Lyle Williams, and Joel Deckard.

Also present: Peter S. Barash, staff director; Donald P. Tucker, chief economist; Barbara Timmer, counsel; Eleanor M. Vanyo, secretary; and Jack Shaw, minority professional staff, Committee on Government Operations.

Mr. Rosenthal. The subcommittee will be in order.

Today's hearing continues the Commerce, Consumer, and Monetary Affairs Subcommittee's investigation into the Federal response to recent events in the silver and related financial markets.

The Chairmen of the Commodity Futures Trading Commission and the Securities and Exchange Commission and the Commissioners of the CFTC have already testified before this subcommittee on this subject.

Today we will be examining the following issues with Chairman Paul Volcker of the Federal Reserve Board and John Heimann, Comptroller of the Currency.

What was the impact on our Nation's banking system of the recent collapse of the silver market?

What was the nature of the Federal bank regulatory response to events prior and subsequent to the collapse of the silver markets in late March?

What meetings and discussions were held with other Federal regulators; for what purpose and with what results?

What has been the impact of the Federal Reserve's credit restraint programs on the commodity markets and silver trading patterns and commodity speculation?

What structural mechanisms presently exist between the Federal banking agencies and other Federal agencies responsible for supervising related financial markets, for the timely exchange of information and regulatory views?

Is the current interagency mechanism adequate? If not, what changes should be made?

Do the Federal banking agencies impose restrictions on and does the bank examination process concern itself with bank participation in or funding of silver and other commodity speculation?

Have Federal bank regulatory officials been kept apprised of efforts by the Hunts to obtain loans relating to their trading activities in the commodities markets?

What do the Federal bank regulators know about these matters and what role, if any, did they play with respect to them?

What meetings or discussions have been held between Federal banking officials and the Hunt brothers or their representatives?

Do the Federal banking agencies have any recommendations concerning foreign bank and trader reporting, contract limits and/or margin requirements in commodity trading, limits on brokerage house loans to individual customers and oversight of precious metal trading?

Do the Federal bank regulators have any recommendations as to changes in Federal regulatory jurisdiction over any type of futures trading activity?

Our first witness this morning is the Honorable Paul Volcker, Chairman of the Board of Governors. Mr. Volcker, we are pleased you could be with us.

STATEMENT OF PAUL A. VOLCKER, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. VOLCKER. Thank you, Mr. Chairman.

You have quite a list of relevant questions, and I will address some of them in my statement. I am sure we can get into others later.

Before turning to the substantive questions in your letter inviting me to testify, let me say I am aware of a good deal of confusion, misinterpretation and questions engendered by the initial press reports about my, or the Federal Reserve's, involvement in certain loans to Hunt interests. Under the circumstances, I particularly welcome this opportunity to outline my role and that of the Federal Reserve with respect to assessing the financial repercussions of recent silver market speculation.

As you are no doubt aware, the Federal Reserve has no statutory or other authority over commodity markets in general or the silver market in particular, nor over brokerage or commodity houses buying and selling commodities for their own account or for others. We do have supervisory responsibility for member banks but, with some exceptions, our legal authority does not reach to particular loans to particular customers, nor are we ordinarily informed of specific loans or lending decisions except as part of the ex-post-examination process. The Federal Reserve does, of course, have a general interest in developments in any market that bears significantly upon economic and inflationary developments, and particularly on developments that may affect the safety of our financial institutions, most especially banks.

Because of that general interest, I did initiate inquiries of other agencies with direct responsibility for, or sharing a general interest in, the performance of the commodities markets when reports and rumors first surfaced last fall of unusual speculative activity in silver. Those discussions led to little or no specific information beyond that publicly available. On October 6, 1979, the Federal Reserve did make a general request to banks to refrain from speculative lending as part of the credit restraint program introduced at that time. That action was not specifically directed to the silver market, but did reflect our growing concern about speculative price developments in a number of sensitive commodity markets. Indeed, as we indicated at the time, the highly speculative atmosphere contributed to our decisions with respect to monetary policy generally.

We continued to follow price developments in the silver and other commodity markets as part of our normal economic intelligence throughout the fall and winter. During this period, we had no knowledge, apart from rumors reported in the press, of the size or value of the Hunt positions in the silver market, or of any bank lending against silver. As you will recall, prices moved sharply higher in December and January amid intensified inflationary expectations, but began to fall rapidly after an environment of intense credit restraint developed. In January and February, the organized commodity exchanges also acted to increase margin requirements substantially and to limit individual positions.

The first indication I had of any potentially serious financial consequences arising from the sharp fall of the silver price was in an urgent call at midday on Wednesday, March 26, from a leading brokerage house, indicating that Hunt interests were failing to meet substantial margin calls and that certain loans the brokerage house had with banks, secured by Hunt silver, were either undermargined or in imminent danger of becoming undermargined. As a result, the firm was concerned that its capital position could fall below certain requirements imposed by the SEC or the New York Stock Exchange if the silver price continued declining, and if further margin calls went unanswered.

I immediately alerted the Chairmen of the Commodity Futures Trading Commission and the Securities and Exchange Commission, as well as Treasury officials. That afternoon, as well as in ensuing days, the concerned agencies urgently began to develop further information about the extent of the Hunt involvement in the commodity markets and the potential exposure of other brokerage houses, commodity dealers, and commercial banks involved in Hunt business. While precise and comprehensive data were difficult to obtain, it quickly became apparent that hundreds of millions of dollars were involved in silver credits or personal loans of one form or another. There were also large amounts of credit outstanding to various Hunt business enterprises; while those latter credits basically appeared to grow out of ordinary business requirements and to be well secured, the close relationships of those businesses to the Hunt family warranted close scrutiny of the degree of insulation of those credits from the personal fortunes of the family.

During this period, careful consideration was given by me and others to possible action by the Federal Government with respect to the silver market, but in this event no special Government action regarding the markets was deemed appropriate and desirable.

The Federal Reserve, itself, as I noted earlier, has no authority over commodity markets or brokerage houses. However, among other things, the SEC and CFTC undertook to inspect the position of certain brokers or commodity dealers with Hunt-related accounts, and both the Federal Reserve and the Comptroller's Office, using examination authority where appropriate, began to develop more detailed information on the extent of commercial bank loan exposure, including information on the collateral or other security for loans to the Hunts and Hunt-related companies.

Late on Friday, March 28, I learned of some particularly large forward contracts providing for the purchase of silver by Hunt interests from the Engelhard Minerals & Chemical Corp. at prices far above the current market. Settlement was due after the weekend, with no apparent prospect for payment. Engelhard, while itself in a strong profits and asset position, felt they might be faced with a decision on Monday to sue the Hunts for payment, forcing probable bankruptcy and possibly triggering massive liquidation of silver positions to the peril of all creditor institutions, and indirectly placing in jeopardy the customers and creditors of those institutions in a financial chain reaction. The alternative, as the company saw it, was to negotiate with the help of some banks a credit to the Hunts or intermediaries that would provide time for repayment and avoid forced liquidation of silver in an already nervous, depressed market. The precise nature of the proposed credit was rather vague to me, but the question did arise as to whether such a credit would in any way be considered speculative within the context of our credit restraint program.

After informing other Government officials of this development and considering all the implications of the matter, I interposed no objection to Engelhard pursuing whatever negotiations the company felt essential to protect its own position, but made it quite clear that the net result should not be to free funds for renewed speculative activity by any of the parties. In view of the wider implications, I asked to be kept informed of the progress of any negotiations.

While fulfilling a speaking engagement before the Reserve City Bankers Association meeting in Boca Raton, Fla., that weekend, I learned that the Engelhard and Hunt interests would together approach a group of banks with a refinancing proposal late in the evening on March 30 in Boca Raton.

While the nature of that proposal was not known to me, I asked to be kept informed because of the potential implications for the silver and financial markets. Subsequent to the negotiation, and well after midnight, I was informed that the banks had, or planned to reject the proposal by the Hunts and Engelhard on business grounds. Neither I, nor any other Government official, either instigated or guided these negotiations.

Following the rejection of the proposal to consolidate and restructure the Hunt silver indebtedness, negotiations proceeded through much of the night directly between the Hunts and Engelhard. The results of those negotiations, involving in part the transfer of certain oil properties owned by the Hunts to Engelhard, became known to me in the morning and were announced the same day. This exchange of assets for the Hunt indebtedness to Engelhard involved no credit extension.

In the following days, the Federal Reserve and other agencies continued efforts to develop more comprehensive information on the extent of Hunt and Hunt-related obligations and to appraise the potential vulnerability of banks and other intermediaries. While very large amounts of credit remained outstanding, those creditors who had appeared to be in the most vulnerable position appeared to have extricated themselves, albeit with some losses, some of which, at least, have since been recouped.

Together with representatives of other agencies, I also turned attention to ways of developing means of avoiding further extreme speculative episodes of this kind in the future, with all their implications for the stability of financial institutions and financial markets.

The credit referred to in recent press articles first came to my attention in a general way at the initiative of one of the lead banks involved on Easter weekend. By that time, lending banks had more fully appraised their overall exposure to Hunt interests and had reached at least tentative conclusions regarding the value of available Hunt assets and those of key Hunt-related companies. A small group of banks developed a concept over the next few days about a method of restructuring the Hunt silver indebtedness in a manner that would greatly strengthen the security position of creditors with outstanding silver loans or contracts. In the process, new creditors would in some instances replace existing creditors, while other creditors would essentially exchange old loans with new. The new bank loans would be to and secured by the assets and earning power of perhaps the strongest of the Hunt-related companies, the Placid Oil Co.

Control over the silver and silver contracts, with appropriate safeguards, would pass into the hands of that same company. Silver-related loans to the Hunts would be paid off. The immediate purpose would be to protect more securely the interests of existing Hunt silver creditors, bank and nonbank. That result, in itself, was not, and is not, contrary to the broad public interest in the stability of financial markets and institutions.

I recognize that the outcome, while plainly desirable in the interests of the creditors themselves and financial stability generally, could have as a byproduct some stabilization of the financial position of the Hunts themselves. For that reason, my particular concern was that the funds not be used directly or indirectly to support new speculation by Hunt interests in the silver or in any other commodity market. Moreover, while the creditors and others have a legitimate interest in not forcing liquidation of silver in an unreceptive market at the expense of their own stability, that of other institutions, and the market itself, continued concentration of a massive silver position in the hands of one family or institution is fundamentally unhealthy for the performance of markets.

The bank negotiators indicated they fully understood my concerns on these issues; they have assured me that all parties to the potential loan agreement recognize and share the concern.

On that understanding, and after consulting with other Government agencies, the bank negotiators were informed that our main concern was that the loan be structured in such a manner, through appropriate covenants or otherwise, that the funds not directly or indirectly be used for speculative purposes; that indeed the parties to the agreements refrain from silver or other speculative commodity purchases for the life of the loan. Provided that stipulation could be met, the banks could reasonably conclude we had no objection, within the framework of our loan restraint program, to the negotiations proceeding along the lines of the general concept of the financing arrangement as a whole as outlined to me. The business and credit judgments involved are, of course, entirely their own.

I would emphasize, too, that the arrangements, if completed, will be essentially a restructuring of existing obligations rather than fresh credit, although the total of new bank loans could exceed outstanding bank loans. The difference would reflect refinancing of obligations on futures or forward contracts or loans extended by brokerage houses from their own funds.

As the negotiations proceeded, I suggested to the banks that they describe the nature of the financing in writing so that I could respond in writing to pin down explicitly the safeguards against speculative activity. As a step toward that end, I and my associates met with bank representatives, as well as with outside counsel involved in writing the loan agreement, so that a clear understanding could be conveyed as to the nature of those safeguards.

These negotiations were then, and are today to the best of my knowledge, incomplete. I believe a fair conclusion from my discussions with the banks would be that the Federal Reserve would not object to the conclusion of the negotiation—indeed, would have no reasonable basis for such an objection in the framework of the loan restraint program—provided the restructuring of the indebtedness in the manner indicated did not contribute to fresh speculative activity. That remains my judgment today.

I hope this recital makes it evident that neither I nor any Federal Reserve or Government official instigated or guided the negotiation of the credit. I did repeatedly insist that any possibility of fresh speculation by Hunt interests be avoided, while not barring orderly resolution of the potential credit and market problem. Indeed, we can count ourselves fortunate that while the Hunt family bears the losses and the residual risk, the fabric of our financial institutions has been unimpaired and, assuming the negotiations are completed, we will have in place protection from renewed Hunt speculation.

The larger issues remain. There is evidence indicating that there was an attempt to control the supply of a significant commodity; to some degree, this stimulated uncertainty and inflationary expectations more generally. As the market price declined, funding of the speculative positions required substantial amounts of credit and certain market intermediaries had, wittingly or not, committed an excessive amount of their own capital in support of speculative activity in one commodity by a single group of people. As the market values collapsed, some of those institutions were placed in jeopardy, and their failure could in turn have triggered financial losses for others and severe financial disturbances. Even today, a substantial fraction of the privately held stocks of silver remains concentrated in the hands of one group, an unfortunate heritage of the past.

Organized commodity markets perform important economic functions. They provide a means for producers, middlemen and consumers alike to hedge positions acquired in the ordinary course of business, thereby facilitating production and commerce. They encourage broader participation in markets, including the kind of "benign" speculation that assures market liquidity and bridges temporary imbalances in ultimate supply and consumption. The markets provide for both buyer and seller a clear set of price quotations established in highly competitive markets.

If the markets are to perform these functions, the costs to those participating in the market cannot be too high, lest the legitimate "hedgers" and "speculators" that together make the market cannot effectively function. Yet, those same low costs can attract an unhealthy kind of speculation, exemplified by the Hunt activities. At the extreme, while it is very rare, situations can arise in some of the more limited markets where relatively few operators, or even one group, may be tempted for a time to operate in such a manner as to virtually control the available supply and push the prices to extremes in the hope of reaping extraordinary profits.

In the end, the best defense against that type of behavior must be the discipline of the market itself. History is replete with efforts at "cornering" that failed. I hope the recent silver experience has had a chastening influence. But memories are short; human greed leads to temptation and an attempt to corner, successful or not, can be extremely damaging, not just to the speculator, but to all those who count on the stability of markets and financial institutions.

The question is how to minimize the dangers—arising rarely—without smothering the markets in their useful—even indispensable—everyday work. I have no specific recommendations to make this morning about the structure and regulation of these markets. Indeed, I would caution against striking out with hastily conceived restrictive legislation with respect to organized futures markets. Those markets already have some considerable financial safeguards embedded in their structure. One danger from excessive regulation or the imposition of heavy costs is that activity will shift to unregulated channels here or abroad, potentially leaving the markets more vulnerable than before to manipulation or credit weakness.

I do not suggest at all that the status quo should be left unquestioned. In discussions with colleagues in Government, I have urged that the interested agencies sponsor and complete within the shortest feasible time period a dispassionate study drawing upon thinking and experience outside the Government as well as within—and the simple fact is the requisite knowledge and experience within Government is limited. Specific questions of the amount and form of margin requirements, of position limits for traders, prudent capital requirements for market middlemen, and other issues are sure to be relevant, and no single reform is likely to provide a complete answer.

I am simply not able today, in so highly specialized an area, to indicate with any confidence detailed judgments on these questions. Indeed, I believe it would be unwise to do so before I can benefit more fully from the thinking of others familiar with market needs and problems. But I assure you I do intend to pursue this matter, and to share my conclusions with the relevant committees of the Congress.

Finally, I cannot refrain from emphasizing that the environment of inflation and the uncertainty and doubts about the future that accompany inflation provided the fertile breeding ground for the recent speculative activity in commodity markets generally—speculation that reached an extreme form in the case of silver. Stable, well-functioning markets ultimately depend upon a sense of stability and confidence in our currency and certainly that sense of stability is at the center of our policy considerations in the Federal Reserve.

Thank you, Mr. Chairman.

Mr. **Rosenthal**. Thank you.

Mr. Heimann.

STATEMENT OF JOHN G. HEIMANN, COMPTROLLER OF THE CURRENCY, DEPARTMENT OF THE TREASURY

Mr. **Heimann**. Thank you, Mr. Chairman. I am pleased to appear before the subcommittee to testify in response to your letter of April 25, 1980, regarding recent events in the silver market.

Your invitation requested that my testimony focus upon the nature and extent of any involvement in or knowldge by the Office of the Comptroller of the Currency of silver-related bank loans to the Hunts. You also requested that I comment upon the nature and extent of OCC bank regulatory activity related to events in the silver markets and the financing of Hunt silver trading activities between January 1, 1979, and the present.

I should note at the outset that no official of the Office of the Comptroller of the Currency initiated or approved any loans to the Hunts, silver-related or otherwise.

More generally, and as you are aware, the Comptroller's Office does not have direct supervisory authority over commodity markets. Our supervisory responsibility in this area ordinarily would arise only in the context of review of significant loans in national banks which might be collateralized by silver or some other commodity or a contract for its purchase or sale.

We did have reason to believe, largely from published accounts, that members of the Hunt family had been active purchasers of silver since the early 1970's. However, I am not aware of any significant information available to the Comptroller's Office with respect to the Hunts' silver activities prior to the widely publicized events of late March 1980.

During the last few days of March significant elements of the financial markets, including the stock market, bond market, and silver market, were in general disarray.

On March 26 and 27, 1980, the Comptroller's Office received information that the Hunts were experiencing difficulty in meeting margin calls on silver positions. Because of the size of the positions involved, we were concerned with the potential direct or indirect impact of the Hunt difficulties upon the banking system and financial markets. Together with other regulatory agencies including the Federal Reserve, the Commodity Futures Trading Commission, and the Securities and Exchange Commission, we recognized that at least some potential existed for translation of the Hunt difficulties through other significant elements in the market, including brokerage firms, commodity dealers, and commercial firms, which might be unable to make commercial settlements in the normal course of business.

Accordingly, we endeavored immediately to obtain as much information as possible concerning exposure of the banking system to the Hunts. Our inquiries included meetings with other regulatory agencies, conversations with a variety of market participants, and special examinations of a number of national banks.

Our staff concluded that the U.S. domestic banking industry did not play a major direct role in financing the Hunts' silver positions during the rapid rise in silver prices from January 1979 to January 1980. Instead, the financing appeared to have been available to the Hunts through other means, including extensions of credit from commodity and brokerage firms as well as international institutions. Moreover, most of the credit directly available through the U.S. domestic banking system to the Hunts appeared to have been extended for the normal business use of Hunt-related companies and, in most cases, to have been adequately protected.

In terms of assessing systemic risks, however, our concerns extended to the exposure which could be indirectly transmitted to the banking system as a result of financial difficulties of brokers, commodity dealers and certain commercial firms, which could have their ability to service normal business obligations to the banking system undermined if they took large losses arising from transactions involving the Hunt silver trading. At the time the markets appear to have weathered that immediate impact or the immediate impact of the Hunt difficulties.

Efforts to resolve the Hunts' financial difficulties and related exposures throughout the financial sector—including current loan negotiations associated with a restructuring and improved collateralization of the silver-related Hunt indebtedness—are, to the best of our knowledge, continuing.

From time to time, we have received reports as to the status of these negotiations. As noted earlier, officials of the Comptroller's Office have had no contact with the Hunts or their representatives with regard to this transaction. We shall, of course, be extremely interested in the results of these negotiations as they ultimately may relate to exposures in the banking system and the financial markets generally.

From our current perspective, we perceive that modification of the current regulatory approach to prevent extraordinarily damaging activities in the commodities markets is warranted.

At the same time, we would counsel against overreaction which could significantly impede the ability of the market to function efficiently in its entirely appropriate roles of providing liquidity and translating or limiting risk. We would be pleased to participate in a study of this issue.

Thank you very much.

Mr. Rosenthal. Thank you very much.

Mr. Volcker, it was reported in the press only this week that the total line of credit being established by a number of banks to the Hunts via Placid Oil is about $2 billion. Does that sound correct to you?

Mr. VOLCKER. No. To the best of my knowledge, the amount has not been settled. There are outstanding loans and there have been outstanding loans to Placid Oil in the ordinary course of Placid's business, let me exclude those. The discussion about this particular credit focused, to the best of my knowledge, on an $800 million figure that had been in the press. There has been discussion more recently of increasing that somewhat to take care of further contingencies that the banks and the creditors have been concerned with, but a $2 billion figure is not at all familiar to me.

Mr. ROSENTHAL. I get that, and I quote from the Wall Street Journal of April 18. It says:

> The largest involves a transaction in which Placid Oil Co. signed a $2 billion note to secure loans from a group of banks headed by Morgan Guaranty Trust Co., and First National Bank in Dallas.

From basically the information you have, do you think that is incorrect?

Mr. VOLCKER. I am not familiar with all the details of this negotiation, but I suspect there is some confusion between the collateral and security being placed behind the loan and the size of the loan itself.

Mr. ROSENTHAL. It is pretty simple language. It says Placid Oil signed a $2 billion note.

Mr. VOLCKER. I am not in day-to-day contact with this matter. To the best of my knowledge, the general loan agreement has not been completed, there has been nothing signed. There was a preliminary, partial arrangement made as a temporary matter, I understand, in a much smaller amount, but, as I say, the negotiation is incomplete to the best of my knowledge.

I am sure that was right as of yesterday.

Mr ROSENTHAL. I am trying to pin down some numbers. The same article says that "Three Hunt brothers"—that adds the other brother—"and the family-owned oil company have mortgaged at least $3.2 billion of oil and gas properties."

Mr. VOLCKER. This is a detail I have no firsthand or secondhand knowledge of but I believe, again, this refers to the property that is being mortgaged, which has been worth that and more. That is not the size of the credit.

Mr. ROSENTHAL. I am trying to find out because I think the public is interested, certainly the Congress is interested, in how much money banks are putting up on behalf of the Hunts all told in any fashion.

Mr. VOLCKER. That is a question that permits no simple answer, because you have to tell me what you mean by the Hunts.

Mr. ROSENTHAL. I have yet to meet the Hunts, so I can't describe them.

Mr. VOLCKER. I have yet to meet the Hunts either, and I have made no effort to do so.

Mr. ROSENTHAL. I have made an effort.

Mr. **Volcker.** I am just drawing a distinction between what might be called the personal ventures of the Hunts, and a number of companies in which they have an ownership interest.

Mr. **Rosenthal.** Moneys are being put up so the Hunts can pay the silver-related debts.

Mr. **Volcker.** Not all the companies are involved; credit involves one of those companies, the Placid Oil Co.

Mr. **Rosenthal.** I understand. I am trying to find out, if you know—it may well be that you don't know and it may well be that we will have an opportunity to ask the Hunts, if that ever happens—how much altogether is the U.S. banking system putting up to solve the Hunts' silver-related problems.

Mr. **Volcker.** You are speaking of this new credit that is under discussion?

Mr. **Rosenthal.** I am speaking of new, old, any credit.

Mr. **Volcker.** The new is to replace the old, essentially.

Mr. **Rosenthal.** I am trying to find out, how much money U.S. banks are putting up to help the Hunts solve their problem.

Mr. **Volcker.** When you say, "are putting up," I just want to be clear what the question is. You are referring to this new credit, which essentially replaces the outstanding credits, not just from the banks but the brokerage houses?

Mr. **Rosenthal.** Altogether—I can't seem to find a way to express it properly—altogether, if you wanted to tell this to the man in the street, how much money is being put together by the U.S. banking system to help the Hunts in their silver-related problems?

Mr. **Volcker.** I am not trying to confuse the issue at all. If you speak about the amount of money being put together, I interpret that reference to be to this new credit that has been referred to in the press. To the best of my knowledge, the banks have been operating for some time on the assumption that that credit would amount to $800 million, not all of which may be used. They wanted a safety margin. In the most recent days, my understanding is that that amount could be increased by let's say $200 or $300 million more—I don't know exactly how much.

The difference between those figures, in my understanding, takes account of some Hunt obligations that are involved in joint ventures.

Mr. **Rosenthal.** I am trying to find out altogether.

The Wall Street Journal says that the three Hunt brothers and a family-owned oil company have mortgaged at least $3.2 billion of oil and gas properties.

I assume when you mortgage something——

Mr. **Volcker.** Not all.

Mr. **Rosenthal.** $3.2 billion transferred hands.

Mr. **Volcker.** I cannot testify to a Wall Street Journal article, but I assume the confusion is over what may be equivalent to mortgaging your house. Your house may be worth $100,000. You borrow $50,000, but you put up the house which is worth $100,000. I assume that article may be referring to part of the security which is being placed behind this loan, not to the size of the loan.

Mr. **Rosenthal.** Not only put up the security and get something in return for it?

Mr. Volcker. Yes, but I am trying to say to the best of my knowledge, the size of the loan will be in excess of $800 million, but nothing like $3.2 billion.

Mr. Rosenthal. The same article said that Placid Oil signed a $2 billion note. To the best of your knowledge, is that correct?

Mr. Volcker. To the best of my knowledge, Placid Oil has not signed a $2 billion note. I don't know what that reference is to, I have no idea.

Mr. Rosenthal. Do you feel comfortable in what knowledge you have as to the amount of money that is being handled on behalf of the Hunts? It may be that you are not familiar with it.

Mr. Volcker. I feel that I am generally familiar. I would not want to affirm that I know all the details of the Hunt financial position. I have to rely upon what we learn directly or indirectly.

Mr. Rosenthal. Based on the knowledge you have, what is the outer limit of all the mortgaging and loans that the Hunts are presently working on?

Mr. Volcker. Are you asking me how much credit is now outstanding?

Let me approach it this way: let me go backward.

To the best of my knowledge—and it is not clear in all cases how much of this is directly silver related and how much is not—but I would estimate that, apart from the Engelhard obligation—which was a very large single obligation on a forward contract, at the time this problem arose late in March, the Hunts had substantially in excess of a billion dollars of obligations on silver. That is not all bank loans, that includes obligations to brokerage houses.

Mr. Rosenthal. We have reports of April 25 that at the Boca Raton meeting, which we will come to in a minute, the Hunts represented debts, silver related, as $1.7 billion.

Does that number sound familiar to you?

Mr. Volcker. Including the Engelhard contract that is consistent with the figure I have just given you. I don't know precisely what they represented to the banks at Boca Raton, but that would be something in excess of a billion dollars, as I mentioned, excluding the Engelhard contract. The Engelhard contract was for several hundred million dollars, so that would come up to a total of the sort that you cited. The Engelhard contract is disposed of, so that figure is no longer in there.

Mr. Rosenthal. Speaking of Boca Raton, this week's Newsweek says, and I quote:

> Engelhard officials and the Hunts themselves then flew to Boca Raton to present their case. Among the bankers present was Fed Chairman Volcker, who weeks before had asked U.S. banks to curtail lending for speculative ventures and who, sources say, had to be yanked into the meeting to hear the Hunts' plea.

Were you yanked into the meeting?

Mr. Volcker. No, I was not yanked into the meeting. I heard no plea from the Hunts. I am not even sure the banks met with the Hunts, but they certainly met with the Engelhard interests, and I was informed after that meeting, as I indicated in my statement, that the banks were not going to make that credit.

Mr. Rosenthal. Now, did the banks discuss with you whether the Federal Reserve would accommodate them in making some money available to them?

Mr. **Volcker.** The question was not relevant at that time because they weren't making the loan.

I had indicated, when the Engelhard representatives had indicated to me the nature of their problem earlier, that whatever arrangement they made to protect their interest should, and must, take account of the fact that we did not want credit extended in a way that would stimulate further speculation.

Mr. **Rosenthal.** I have two questions. Were you in a meeting with the bankers and the Hunts?

Mr. **Volcker.** No. Again I don't know whether the bank has met with Hunt. They certainly met with Engelhard. My memory is that I think I was told they did not meet with the Hunts. But I wasn't there anyway.

I was called after that meeting. I joined the bankers at that time, and they told me they had had this very vague proposition presented to them and they turned it down.

Mr. **Rosenthal.** Now, did the bankers ask you to have the Federal Reserve make special accommodation to them to make available this billion or whatever the number is?

Mr. **Volcker.** No. They had already turned it down.

Mr. **Rosenthal.** But the negotiations are still going on.

Mr. **Volcker.** That is a different credit. You are talking about Boca Raton, which was a negotiation with Engelhard, Hunt and the banks. Engelhard is now out of this.

Mr. **Rosenthal.** I am talking about Boca Raton.

Mr. **Volcker.** Okay. Let's limit it to Boca Raton. Engelhard and the Hunts flew to Boca Raton, as you indicated. They had a negotiation, a bilateral negotiation; Engelhard discussed with the banks—I don't know as Hunt did—whether the banks would participate in a credit. The banks said no.

Mr. **Rosenthal.** And that was the end of the Hunt refinancing?

Mr. **Volcker.** That was the end of Boca Raton. What happened then was Engelhard and the Hunts reached an agreement where the Hunts transferred certain property to Engelhard in satisfaction of the Engelhard claim; period.

Mr. **Rosenthal.** What did the banks ask you to do?

Mr. **Volcker.** The banks didn't ask me to do anything.

Mr. **Rosenthal.** What did they tell you they were doing?

Mr. **Volcker.** They didn't tell me they were doing anything.

Mr. **Rosenthal.** They said they were up to 4 o'clock in the morning.

Mr. **Volcker.** They were up to 4, or whatever hour, discussing the matter.

Mr. **Rosenthal.** What time of the night did you talk to the bank or the bankers? Were these banks?

Mr. **Volcker.** It was a group of banks. Representatives of all the large banks in the country were at Boca Raton because they happened to be having this convention, and the Engelhard people asked at least one of the banks to get a group of bankers together so they could discuss this credit.

One of the bankers informed me of this meeting. I said, "Well, would you please keep me informed as to the outcome of the meeting?"

Mr. **Rosenthal.** Why did you do that?

Mr. Volcker. Because I was very interested in repercussions for the market and for the financial system.

Mr. Rosenthal. Did you have any interest in the banks refinancing the Hunts?

Mr. Volcker. I was interested in the outcome of the negotiation; I certainly was.

Mr. Rosenthal. Why?

Mr. Volcker. Because of its implications—very important implications—for the performance of markets and for the health of the financial system on Monday morning.

Mr. Rosenthal. And why is that?

Mr. Volcker. While I have no direct responsibility for the commodity market, I certainly have an interest in what goes on in the financial system and in markets generally. I cannot conceive of not having an interest in this matter.

Mr. Rosenthal. No, no. Were the Hunts threatening the financial markets in this country?

Mr. Volcker. Threatening in what sense?

Mr. Rosenthal. Any sense.

Mr. Volcker. You say the Hunts, implying that they went out to threaten the financial market. The situation was a serious concern to the financial markets, of that there is no question.

Mr. Rosenthal. How would you rate your level of concern? Very concerned, moderately concerned, seriously concerned, gravely concerned?

Mr. Volcker. I was very concerned. When there are major brokerage houses in potential difficulty, I am concerned.

Mr. Rosenthal. Now, what the American public is interested in knowing is should something be done so that two or three brothers cannot bring the financial markets or the situation to where you were deeply concerned?

Mr. Volcker. Yes; I think this is a very unfortunate situation and I do think that this situation needs considered study. That is precisely what we intend to do, to make such recommendations as we deem necessary to minimize the chances of this sort of thing happening again.

Mr. Rosenthal. Now, these banks that are putting this loan together, it is still in the putting-together process?

Mr. Volcker. Let me make a distinction. The Boca Raton discussion arose out of the particular problem between Engelhard and the Hunts and had wide ramifications, but at that point the Hunt-Engelhard problem was taken care of by a bilateral negotiation. Subsequent to that time, with the same problem existing in less acute form, a group of banks had developed a concept for strengthening the interest and protecting the interest of the various creditors involved through a restructuring of this debt. That is a different discussion, a different credit, it is still going on today.

Mr. Rosenthal. Is it a correct statement to say that the Hunts are presently negotiating a loan from a group of banks for about $1 billion?

Mr. Volcker. Yes.

Mr. Rosenthal. What interest rate are they going to pay?

Mr. Volcker. The interest rate is certainly going to be a market interest rate. But I think questions of that sort—which are basically about a commercial bank decision—could perhaps be better directed toward those negotiating the loan.

Mr. ROSENTHAL. Have you in any way indicated the Federal Reserve would be cooperative with the banks in assisting them making that loan?

Mr. VOLCKER. My indication to the banks, consistently, has been that our principal interest in their negotiation from the viewpoint of our credit restraint program is that this credit should be structured in such a way to provide the maximum assurance that it will not contribute to further speculation in the silver commodities or securities markets.

Mr. ROSENTHAL. In other words, you want strict covenants in the loan agreement?

Mr. VOLCKER. Yes.

Mr. ROSENTHAL. Are you going to make any money available to these banks?

Mr. VOLCKER. No.

Mr. ROSENTHAL. Is that an absolute, final statement?

Mr. VOLCKER. The Federal Reserve itself?

Mr. ROSENTHAL. Yes.

Mr. VOLCKER. We are not going to make any money available, no, sir. This is a negotiation by existing creditors to restructure the loans.

Mr. ROSENTHAL. How will this affect the credit markets altogether, this $1 billion loan to the Hunt brothers?

Mr. VOLCKER. To the extent that the position of banks and other lenders is strengthened, I think, indirectly, it adds stability.

Mr. ROSENTHAL. Is this the largest single private bank loan in U.S. history?

Mr. VOLCKER. I don't know what you mean by "private" bank loans. And I don't know the amount.

Mr. ROSENTHAL. Do you know if it is a loan to two individuals——

Mr. VOLCKER. This loan—the loan that they are now discussing—will not be to the Hunts or the Hunt family, it will be to the Placid Oil Co.

Mr. ROSENTHAL. But that is the same Placid that has just signed a $2 billion note, which you say you are not familiar with.

Mr. VOLCKER. You keep quoting a Wall Street Journal article that I accept no responsibility for. If I had to accept responsibility for all press reports, I would be in great difficulty.

Mr. ROSENTHAL. At any rate, you were not yanked into the Boca Raton meeting?

Mr. VOLCKER. No. I did meet with the banks after they had either—I do not recall—conclusively told Engelhard they weren't going to make the loan or informed me that they were about to tell Engelhard they were not going to make the loan. I did join the meeting, so that the banks could inform me of what——

Mr. ROSENTHAL. Are you prepared to come before the Congress with recommendations to deal with situations like this?

Mr. VOLCKER. I would hope that we could do it in a matter of just a few months, I think it takes that. This is a rather rarified area in terms of commodity markets, how the financing takes place, what all the considerations are; it is rather intricate. We are looking for some outside advisers, in effect, who can join with us in taking a view of this market and coming up with a coherent set of recommendations that would minimize this kind of speculative effort as a threat in the future. It is very unfortunate, it is very undesirable that we have a market of this sort where so much of the supply can be in the hands of a single interest.

Mr. ROSENTHAL. What percentage of the supply was in their hands?

Mr. VOLCKER. It depends, I think, upon how you compute supply. Estimates are not ideal, and we have a big "estimated stock" figure in all these data. Let me see whether I can give you some idea. It is estimated that about 170 million ounces or so at the end of 1979 was in private hands; this is identifiable through the various industries that hold stocks of silver or the various commodity exchanges.

Now, there are also unidentified stocks of, or estimated stocks of, some considerable size as well. But if you take that 170 million ounces of readily identified stocks in the United States, I would guess that Hunt or Hunt-related interests may have had two-thirds of them at one point.

Mr. ROSENTHAL. And where were you all this time?

Mr. VOLCKER. All what time?

Mr. ROSENTHAL. While they were amassing this two-thirds interest.

Mr. VOLCKER. I made some inquiries about this.

Mr. ROSENTHAL. I have here a memorandum from Read P. Dunn, Sr., with one of the Commissioners of the Commodity Futures Trading Commission. I am just going to read it. I apologize to my colleagues for consuming so much time. This is a memorandum, dated April 9, 1980, entitled:

> Notes on Discussions with Treasury Department and the Federal Reserve Board on Silver, September 1979 through March 1980.
>
> When a certain amount of congestion was observed in the silver futures market, I called the Treasury Department and the Federal Reserve Board in September 1979 to ascertain the nature and extent of their interest in the silver and gold markets, and to learn whether they monitored the futures market or were particularly concerned about developments.
>
> At that time I learned they considered silver as just another commodity and expected the prices would move up and down, as in the case with other commodities.
>
> They showed no particular interest in silver.

Mr. VOLCKER. I am afraid that is entirely misleading as to my concern. The fact is that I instigated, myself, several requests of the Commodity Futures Trading Commission as to what they knew about what was going on during this period.

Mr. ROSENTHAL. When was that?

Mr. VOLCKER. I believe once in September and again in December.

Mr. ROSENTHAL. Do you have any memorandums to indicate that?

Mr. VOLCKER. No, sir.

Mr. ROSENTHAL. Anything in writing?

Mr. VOLCKER. No. The requests went through my assistant who talked with members of the Commodity Futures Trading Commission.

Mr. ROSENTHAL. One other question. He then begins the next paragraph by saying:

> Following the International Monetary Conference at Belgrade, both the Treasury and the Federal Reserve Board became more interested in the precious metals but primarily in gold.

When was that International Monetary Conference in Belgrade?

Mr. VOLCKER. At the end of September or the beginning of October. It was right at the turn of the month, between September and October.

Mr. ROSENTHAL. He said you still weren't interested in silver.

Mr. VOLCKER. I don't know what basis he had for that judgment. But, as I indicated, it is obviously not part of our responsibility to regulate commodity markets. As I also indicated in my statement, we have a general interest in the performance of commodity markets.

Mr. ROSENTHAL. It is an area that worked itself out and you became very, very interested in it to the point that one of the articles in the Washington Star reports that:

> Federal Reserve Board Chairman Paul A. Volcker said yesterday he would rely on "moral suasion" to make sure a proposed $800 million dollar line of credit to the billionnaire Hunt brothers does not fuel more speculation.

You are a principal in this billion dollar loan to the Hunts.

Mr. VOLCKER. I deny that I am a principal in the loan to the Hunts. I have expressed repeatedly my concern that that loan to the Hunts not facilitate or make possible further speculation in the silver or commodity markets.

Mr. ROSENTHAL. Mr. Williams.

Mr. WILLIAMS. Governor Volcker, I have another area of concern. I think the chairman has pursued his very well.

I am aware that you have just returned from Europe. Can you indicate to the subcommittee whether the recent shakeout in silver has caused any serious problems for European banks, especially in terms of their dealing with Mideast clients?

Mr. VOLCKER. I don't quite know how to answer that. Let me say, in general terms, the shakeout in the silver market and the shakeout in the commodity markets, in one sense, is a healthy thing. The fact that the speculative fervor has gone into reverse direction is, hopefully, one sign that some of the speculative fervor gripping the economy generally is subsiding. In that sense, it is at least a little early step toward changing the whole psychology of inflationary expectations.

You can have a situation, as threatened to be the case in the silver market, where the unwinding of a speculative situation in fact threatens the stability of some brokerage houses or commodity dealers. You can get an unfortunate situation.

Now, there was some foreign lending involved just as there is some American lending involved in this situation. I have no particular reason to think that the psychology or attitude in Europe is particularly different than in the United States, although most of the activity—the actual buying and selling—was in the United States.

Mr. WILLIAMS. Are any banks in Europe in danger of floundering?

Mr. VOLCKER. I don't know. I do not have any sense that any bank was in danger of floundering because of this. Obviously, there were some potential losses that might have been involved.

Mr. Williams. How could we prevent a group of Mideast individuals, who have the ready cash, from doing the same thing the Hunts have almost accomplished through extensive borrowing?

Mr. Volcker. That is precisely the question. This kind of speculative activity doesn't require credit on the upside of the market; you just pyramid your gains. To the best of my knowledge, there was no substantial amount of bank credit or other credit in the form of extensions of money to the Hunts while the market was performing well. They were making money, and they could keep reinvesting the money. The same thing would apply to Arab interests or whoever else was involved.

Mr. Williams. They were involved?

Mr. Volcker. I think there is no question that to a degree there were some——

Mr. Williams. How much were the Arab interests involved?

Mr. Volcker. Please understand I cannot speak with complete authority about how much some—I am tempted to say shadowy participants that I read about in the papers—are involved. They are not under my jurisdiction. But my impression is that what was involved was only a fraction of the Hunts' interest.

I think your general question is relevant to the performance of commodity markets in general, whether or not credit is involved. What are the appropriate position limits, margin requirements, capital requirements, and all the rest?

The difficulty with this, if I may just emphasize a point I tried to make in my statement, is that it doesn't do you much good to regulate very severely that portion of the market that is already subject to regulation if people can go ahead and do the business, let's say, in Europe, or outside any organized commodity exchange.

If you make that market too inefficient, that is what will happen and, in fact, there is some evidence that some of the weakest positions in this market developed because they went outside the organized commodity markets precisely to avoid what seemed like onerous requirements of the organized markets.

So, as those restrictions got greater, as those organized markets took action—through increasing reserve requirements and otherwise to restrain speculative activity—the speculative activity moved through another and less well-protected channel.

Mr. Williams. I have one further question for Mr. Heimann. You stated in your view that to the extent any brokerage firm found itself in trouble, you felt that was a direct result of errors in judgment by that firm, rather than a fault of any regulatory malfunction?

Mr. Heimann. To the degree that an individual or brokerage firm had overcommitted itself, clearly the management of that firm had made a mistake in judgment, but I agree with the chairman that this is an area that needs considerable study and rethinking in terms of regulation.

Mr. Williams. Both of you seem to indicate that you want to be very careful with any new regulations that might emerge as a result of this shakeout.

Mr. Heimann. I think so, sir, simply because regulation here is not simply defined as to what would be the proper restructuring of regulation.

As outlined in the Chairman's testimony, there are a whole host of areas that should be looked at and it would be a combination of some of those activities, not just simply one of them.

Mr. **Williams**. But I am still picking up that you feel something has to be done; you are going to recommend something to the Congress.

Mr. **Volcker**. Speaking for myself, I don't think there is any question that an incident of this sort in what is, after all, in some sense a relatively small market—the silver market isn't the biggest market in the world—can potentially have very grave repercussions, and so is certainly deserving of careful study to see how this kind of risk can be minimized.

Just looking at the silver market itself—forgetting about the financial repercussions—the price of film was driven up very decidedly during this period at an unfortunate time. The market did not function well in the interests of the people interested in silver.

Mr. **Williams**. Obviously I think that is why the chairman has scheduled the hearings, and I wish we could impress upon the Hunts that this has impacted the Nation. There are some other reasons to be concerned.

Thank you, Mr. Chairman.

Mr. **Rosenthal**. Mr. Atkinson?

Mr. **Atkinson**. Very quickly, in your earlier statement, Mr. Volcker, you stated you had no authority, as I remember, over the commodity markets.

Mr. **Volcker**. That is correct.

Mr. **Atkinson**. Of silver and other sensitive commodities.

Mr. **Volcker**. That is right.

Mr. **Atkinson**. I find an inconsistency with that. Even though you have no authority over that, I guess you assume a responsibility of it. In the Congressional Record in the Extension of Remarks on April 24, Henry Reuss, the chairman of the House Banking, Finance and Urban Affairs Committee, is quoted as stating that:

> The $800 million bank loans appear to be in clear violation of the Federal Reserve's directive of September 1979, repeated as part of the President's credit control measure of March 19, 1980, against bank lending for commodity speculation.

So it seems as though you do have authority.

Mr. **Volcker**. First of all, that is a voluntary program. But forgetting about the voluntary aspects of it at this point, that is precisely the major point that concerned me about this whole renegotiation of the credits, and my principal concern was that this credit not contribute in any way to speculation in the markets.

Indeed, from that particular perspective, we will have the situation much better tied down if the credit is completed than if it is not, because if the credit is not completed we have no direct authority over that speculative potential.

Mr. **Atkinson**. Do you think you should have more authority in these areas?

Mr. **Volcker**. It may be that the U.S. Government should have more authority. It is another question whether the Federal Reserve should have more authority. This is a situation that, because of the way it unfolded, obviously had financial consequences; the commodity markets day in and day out—or year in and year out—involve credit and some financing. But this ordinarily is, if I may say so, primarily a commodities problem and not a monetary or financial problem. So there is a question of where any additional authority should be lodged. That is one of the things that we want to think about.

Mr. ATKINSON. A couple of other quick questions. I think you also stated that financial institutions have not been impaired. I think that was one of your statements.

Mr. VOLCKER. I don't remember that particular word, but I think the financial institutions have, as of now, come through this all right.

The nature of this credit that is being negotiated would be to further strengthen their position.

Mr. ATKINSON. If it were done, would there be massive disruptions to the economy, as others have stated?

Mr. VOLCKER. No, I think that would be too strong. I think you could say that the risks to some financial institutions are greater than they would be if the credit is completed, depending upon what happens in the silver market, and that this whole credit in the most immediate sense, places financial institutions—of which I include brokerage houses, commodity dealers—on a firmer footing than they are now. But they are not in immediate jeopardy in any event.

The institutions that were in the greatest jeopardy have extricated themselves already, so the remaining credits are in what appear to me, as nearly as I can judge, strong hands. But even a strong creditor can be interested in further strengthening his position.

Mr. ATKINSON. One other question and I will conclude with you on this one. You have no idea, you stated, what the rate would be, the prime rate would be, on these loans?

Mr. VOLCKER. I have heard what it would be, but I don't remember the precise terms. I think I can tell you that it is not in any sense a subsidy rate, but I don't recall the exact terms and I don't think I should be the one to——

Mr. ATKINSON. You don't want to speculate?

Mr. VOLCKER. To provide that information.

Mr. ATKINSON. Mr. Heimann, my final question.

There has been some question about the collateral that is going to support these loans and that some of the properties put forth by the Hunt family are oil wells that are not functioning and some question about the actual value.

I realize the lending institutions' responsibility to secure the loans, but I guess my question is, Do you have any role in that? Do you investigate that once the questions are raised?

Mr. HEIMANN. As you know, it is the normal role of the supervisory function to look at loans to decide after the fact, after the loan has been made, whether or not it is properly collateralized or whether the collateral is fairly evaluated and the like. That is the normal function of the examination process.

Assuming this loan is made, Federal bank supervisory authorities will evaluate that loan in order to determine whether or not it should be classified in any sense, and classification would come for financial reasons or inadequate collateral.

I would assume, sir, that the banks who are in the process of negotiating this loan will make quite certain that there is sufficient collateral behind that loan.

Mr. **Atkinson**. Thank you. Thank you very much, Mr. Chairman.

Mr. **Rosenthal**. Could you tell us who the lead banks are in this billion dollar loan, if you know?

Mr. **Heimann**. You are just throwing that in the air for either of us?

Mr. **Rosenthal**. Either one of you.

Mr. **Volcker**. Let me say there has been some reference in the press to two institutions which, in this case, coincides generally with my understanding. Let me emphasize, in that connection, that these banks are perhaps most active because of both their knowledge and position in the financial community and this does not imply any unusual exposure on their part; they are indeed strong institutions.

Mr. **Rosenthal**. Can you tell us the names of the banks?

Mr. **Volcker**. The two that have been mentioned in the press are, I believe, Morgan Guaranty in New York and First National Bank of Dallas.

Mr. **Rosenthal**. Mr. St Germain.

Mr. **St Germain**. Thank you, Mr. Chairman. To be honest with you, Chairman of the Fed, I am a little puzzled at the presentation this morning and the answers to the questions.

Certainly to state that the Fed, as well as the regulatory agencies shouldn't be that concerned initially until bank participation really becomes more prominent, I don't buy. I cannot agree with that.

I say that because the brokerage houses involved borrow their money, do they not, to cover what they have indeed lent to the Hunt brothers in this instance?

Mr. **Volcker**. They may or may not. In some cases they did, but not in all cases.

Mr. **St Germain**. If they don't borrow money, Mr. Chairman, then why would they have been in a precarious position when this broke, when the price of silver began to drop?

Mr. **Volcker**. I think generally they did borrow the money, but if they happened to have enough cash of their own, they didn't have to borrow the money.

Mr. **St Germain**. I think that is what is bothering me about this testimony. We are equivocating. I think we are playing games. Very seriously now, because, as you know, I have overseen, I have investigated failures of banks in this country for a period of 10 years now.

Mr. **Volcker**. I don't quite understand what you mean by "equivocating."

I tell you the fact that in some cases the brokerage houses did borrow from the banks and in other cases they did not.

Mr. **St Germain**. The reason that you said this was a serious situation in your statement is that it could have meant the failure of some of the principal brokerage houses in this country. Is that not the case? Is that not your testimony?

Mr. VOLCKER. That is correct, but that could have occurred whether or not they put the money up themselves. They would have lost money in either case.

Mr. ST GERMAIN. By the same token, there is bank credit involved to a great degree in this entire situation.

Mr. VOLCKER That is correct.

Mr. ST GERMAIN. Now, you know, you answered the question and you said well, the loan isn't to the Hunts; it is to Placid. Placid is wholly controlled by the Hunts, Placid being used as a conduit for the Hunts' silver speculation. You know, the administration made a big deal——

Mr. VOLCKER. Wait a minute, if I may interrupt, Mr. St Germain. I was talking about this new credit, which will not be a conduit for any speculation; that has been my concern throughout.

Mr. ST GERMAIN. It is a conduit to take care of the speculation that they have been involved in.

Mr. VOLCKER. It is to repair and reorganize the debts that arose from the earlier speculations.

Mr. ST GERMAIN. As a result of their speculative involvement.

Mr. VOLCKER. That is right.

Mr. ST GERMAIN. In an attempt to control the silver market?

Mr. VOLCKER. That is correct.

Mr. ST GERMAIN. Mr. Heimann, have any of the Hunt loans been flagged by any of your examiners?

Mr. HEIMANN. You mean the silver-related loans?

Mr. ST GERMAIN. Silver or non-silver-related loans.

Mr. HEIMANN. This has just been a question of terms. In certain examinations, obviously not specifying the institutions, in which the Hunt family and Hunt-related businesses were important customers of the banks, the answer is yes, under the principles of concentration.

Even though each individual loan may have stood on its own, it must be collateralized but that has been noted in certain institutions.

Mr. ST GERMAIN. Without referring to specific institutions or specific loans, I am concerned about another aspect of this. Have your examiners or those of the Federal Reserve Board, in going over these loans, Hunt-related loans, whether directly for their speculation in silver or for other purposes—when an application is made for a loan it is required that the applicant, borrower, state his or her or its financial position, to wit, what other loans outstanding, what other obligations to other financial institutions or to brokerage houses? That is a requirement, is it not?

Mr. HEIMANN. The financial position of the borrower and good practices, yes, sir.

Mr. ST GERMAIN. Have you indeed looked or have your examiners looked at the loans to the Hunts over this period of time during which they were speculating in silver to determine if they accurately and truthfully filled out those financial statements when applying for loans that were granted?

Mr. HEIMANN. To my knowledge, I can't say this is 100-percent correct because we really have to look at each one to make sure, but to my knowledge going back over a period of time the financial statements of the Hunts in the institutions from whom they were borrowing were accurately represented, well collateralized, and presented, I gather, an accurate picture of their financial position.

I don't know if those were certified statements or not, however. That I would have to check.

Mr. **St Germain**. Chairman Volcker, have you discussed this with your examiners?

Mr. **Volcker**. I have discussed with my examiners what we knew about the Hunt loans before and after.

I am not sure whether you are referring to what can be thought of as the personal loans or to the company loans. The company loans were evaluated in the normal routine. Many have been outstanding for some time. No problem has been brought to my attention in any connection with those loans.

I think the personal loans tend to be more recent and I am not aware of any specific examination that involved those loans before this whole situation broke, because the loans were relatively recent.

Mr. **St Germain**. In this situation down in Boca Raton, Mr. Chairman, you state that you were informed after midnight of what was occurring in the negotiations. As a matter of fact, tacitly, weren't you indeed monitoring what was occurring in these negotiations that were taking place between Engelhard, the Hunts, and the financial institutions or banks?

Mr. **Volcker**. In one sense I suppose you could use the word "monitoring." I certainly wanted to be kept informed, no question about that.

Mr. **St Germain**. You indeed asked to be kept informed?

Mr. **Volcker**. Yes, sir.

Mr. **St Germain**. Why did you want to be kept informed?

Mr. **Volcker**. Because it had strong implications for developments in financial markets and financial institutions during the ensuing period, and because I was concerned that any arrangement that would be arrived at should not give rise to any fresh speculative activity.

Mr. **St Germain**. You state in your statement that, and I quote: "The best defense against that type of behavior must be the discipline of the market itself."

If that be the case, doesn't the fact that you, as you just stated, felt that you should monitor to a certain degree and be sure of the fact that credit would be extended sort of negate this concept of the discipline of the marketplace?

Mr. **Volcker**. I must say that the discipline in the marketplace did not——

Mr. **St Germain**. Didn't work very well.

Mr. **Volcker**. Didn't work perfectly, I was about to say. I suppose one could say that the net result of the whole incident is to reinforce the disciplines of the marketplace, and I hope that lesson has been learned. But we did find that some institutions had gotten themselves overextended in this area. And, ideally, they shouldn't have gotten themselves overextended in the first place.

I hope the chances of that happening again are less after this incident, even if nothing else is done, but that is an area that we want to look at.

Mr. St Germain. Would you be a little more specific? You are using the term "some institutions."

Mr. Volcker. I was thinking primarily of some of the brokerage houses or commodity dealers that have gotten themselves involved in very large transactions with the Hunts. Then, when the market went completely in the other direction, I suppose, to them, the unthinkable happened. The Hunts were having difficulties meeting their obligations, and they found that their own obligation therefore was great enough to raise some questions about their own potential viability.

Mr. St Germain. By "institutions," you are referring primarily to commodity trading organizations?

Mr. Volcker. Yes.

Mr. St Germain. And to brokerage houses?

Mr. Volcker. Yes.

Mr. St Germain. You do not include financial institutions?

Mr. Volcker. No, not——

Mr. St Germain. To the best of your knowledge, were there any loans extended to the Hunts from financial institutions during this period of time that were used for their speculative activity?

Mr. Volcker. My sense of that, Mr. St Germain, is that the overwhelming bulk of the direct bank involvement arose on the down side of the market.

When the Hunts began to have to raise money to meet margin requirements, either because the price was declining or because margin requirements had been increased, they had to raise some cash; at that point, it appears that the banks became involved, rather than in financing the initial speculation itself.

Mr. St Germain. Let's go back then to my question of Mr. Heimann and yourself a few moments ago.

When they began going to the banks on the downside, again they had to file these financial statements in order to obtain the loans.

Now, were these loans obtained from one particular institution, from various institutions, from a lead bank?

Mr. Volcker. There were a number of institutions involved and not——

Mr. St Germain. Were they acting independently?

Mr. Volcker. Yes. I think, essentially, acting independently. But going back to your earlier question, I suppose the principal bank involvement was through financing loans that had been made in the first instance through a brokerage house. It is not clear to me that in all cases—and perhaps maybe not even in most of the cases—the banks were actually aware that, in a sense, the ultimate exposure at the other end was to the Hunts.

They were dealing with the brokerage house. In other words, the brokerage house arranged the credit, and the credit was to the brokerage house in the first instance.

Mr. St Germain. Do you feel that it would be important as a result of this most unique and unusual situation to look very carefully at the method used by the brokerage houses as well as the Hunts to obtain additional credit, particularly on the downside, to determine whether indeed all of the statements that are required by financial institutions as to the purpose of the loan, as to other obligations, the overall financial picture, were accurately answered?

Mr. **Volcker**. Yes, I think that is relevant. Mr. Heimann has been involved in that aspect perhaps more closely than I. I don't know whether he wants to add any further comment.

Mr. **Heimann**. No, I think that is clearly a requirement. I think the complication here, Mr. St Germain, the banks directly were not involved in silver-related loans over this long period of time.

Mr. **St Germain**. Talk about the downside.

Mr. **Heimann**. Coming to the downside, when they became directly involved, as against financing intermediaries, in that case when the bank is extending a loan to a broker or commodity dealer, the loan is going to the entity and they will take collateral on the general health and strength of that institution.

Mr. **St Germain**. Which obviously in quite a few cases it was not that good?

Mr. **Heimann**. Well, as it turned out, that has been——

Mr. **St Germain**. The Chairman stated, and everyone agrees, the banks now are coming in in a bailout situation much bigger than the Chrysler bailout; in other words, coming in in a bailout situation because, absent that, some brokerage houses were going to fail. Is that not correct?

Mr. **Volcker**. That is probably not true at this stage. That appeared to be the case when the crisis first broke, but, as I indicated, I think the weaker potential credits have already been taken care of.

I think the banks have a continuing interest in getting the maximum strength behind their credits, and they have a continuing interest, as we all do, in this situation not breaking out afresh. But there is a distinction, I think, between the current situation and the situation as it appeared at the time before some of the more vulnerable institutions did extricate themselves.

I also should say, just so there is no confusion, that for certain of the intermediaries that were threatened, that does not mean their capital was impaired, in the sense that they didn't have any capital. They just threatened to go below certain warning signals, in effect, that the SEC and the stock exchanges established so that firms do not fail. The trigger points are reached while there is still adequate capital presumably available to meet the obligation. It is a warning point.

Mr. **St Germain**. In the case of Bache & Co., $230 million.

Mr. **Volcker**. The loss was not that big.

Mr. **St Germain**. In an executive meeting early in March, Jacobs and other bank officials extended a $230 million loan to the Hunts.

Mr. **Volcker**. That is right; they had a credit of that size.

Mr. **St Germain**. But it was obtained by a Bache unit and guaranteed by the parent, from 10 participating banks.

Mr. **Volcker**. That is right. They had a credit of that size. They also had commodity accounts that had margin calls.

Mr. **St Germain**. This is in March of this year at a point in time when you have asked for credit restraints. You have asked the financial institutions to cut down.

Mr. **Volcker**. That is correct.

Mr. **St Germain**. Incidentally, you made a statement earlier in answer to one of the questions that the credit restraints are purely voluntary, but indeed under the Credit Control Act you can within a half hour make them mandatory, can you not?

Mr. **Volcker**. I can't. It would require action by the President, and it would also require action on our part. No; I take those very seriously, which is a major reason why I have been following this so closely and making sure that these credits did not give rise to any fresh speculation. But when one considers the speculative aspects I think it is relevant to point out that the great bulk of these loans arose on the downside. They were, I suppose, in some sense, damage control rather than speculative at that point. The Hunts had to raise some cash to take care of their losses.

Mr. **St Germain**. The Hunts had to raise some cash and they are being allowed to borrow—let's use the smaller figure—$800 million, a very substantial amount of money they are being allowed to borrow to bail out, so to speak, that is being allowed because this means you are going to bail out some brokerage houses that used poor judgment.

Mr. **Volcker**. Let me point out, as your question implies, that credit is already outstanding. This is just a restructuring of the credit. In that sense, the damage or whatever had already——

Mr. **St Germain**. They borrowed $800 million?

Mr. **Volcker**. Yes; they borrowed more than that. When we came into this situation, when the situation broke, these credits were already outstanding. This is restructuring their credit, partly from banks, partly from brokerage houses, partly in open contracts that they had outstanding.

Mr. **St Germain**. The banks and brokerage houses, that money that they borrow from banks in order to let, so essentially——

Mr. **Volcker**. In some cases, yes; in some cases, no.

Mr. **St Germain**. But for the most part it is money that has come from financial institutions, a great amount of money?

Mr. **Volcker**. If you count a brokerage house as a financial institution, it all came from financial institutions.

Mr. **St Germain**. Particularly what it in turn borrows from a bank.

Mr. **Volcker**. All I say is that they didn't all in turn borrow from the banks. Some of them did.

Mr. **St Germain**. Do we know how many and in what amount? Can you find out?

Mr. **Volcker**. It may have been 50-50 or 60-40, something like that.

Mr. **St Germain**. Could you become a little more specific; could that be answered a little more specifically?

Mr. **Volcker**. I can try to give you a little better estimate. I am not sure we know the answer definitively. We may not know every bank credit that was made to a brokerage house that ultimately was for that purpose.

Mr. **St Germain**. But you are saying the restructuring here is for the $800 million, so you can determine what loans that $800 million is being used to repay, can you not?

Mr. **Volcker**. The banks can.

Mr. **St Germain**. Well, in your examinations you find this out as well or you can ask the banks.

Mr. **Volcker**. Except that we don't necessarily know where every loan originated, but certainly the banks negotiating the loan have some idea of just precisely which credit should be repaid.

Mr. **St Germain**. You are responsible for that information, are you not?

Mr. **Volcker**. Eventually, I think so, and part of the concept, as I understand it, is to control the disbursement of those funds extremely closely so it goes precisely to the restructuring.

Mr. **St Germain**. That is as of now, Mr. Chairman, but it was occurring before.

Mr. **Volcker**. If I may make the point again, this speculative activity by the nature of the case, which is one of the elements one has to look at it, can be financed without bank credit—and was financed essentially without bank credit or other credit—so long as the market was going up as it was going up. The credit arose when the market reversed itself and, in a sense, the damage was already done. They owned the silver and then pushed the price up.

Mr. **St Germain**. But now that the downturn has happened, the Hunts' fingers have been burned.

Mr. **Volcker**. Correct.

Mr. **St Germain**. Let's say to the financial institutions of the country, we are saying to the small businessmen and small farmers, hey, we can't give you too much credit. We can't give you the credit, but we are going to bail out the Hunt brothers and brokerage houses involved to the tune of at least $800 million.

Mr. **Volcker**. I am not sure I would use that term, but, again, the credit was already outstanding before I knew anything about it.

Mr. **St Germain**. And we are now allowing this type of borrowing because it was outstanding before——

Mr. **Volcker**. We are allowing—if that is the right word to use—this restructuring. Indeed, I don't think we have any authority to say that the loan can't be restructured. In that sense, it is a normal commercial judgment on the part of the lenders. We have had a concern about the speculative aspects. In that particular sense I might point out if this credit goes through we will be better protected in this area than we obviously were before when we had no protection.

Mr. **St Germain** In this particular instance?

Mr. **Volcker**. That is right.

Mr. **St Germain**. As to the banks who are participating in this, will the Federal Reserve district banks, and through their discount windows, be kind to the banks who are participating in this bailout?

Mr. **Volcker**. No.

Mr. **St Germain**. Or will the banks involved be treated like any other bank, taking into account credit restraints that you were attempting to impose and reimpose?

Mr. **Volcker**. They will be treated like any other bank, and they have been so informed.

Mr. **St Germain**. They have been so informed. Let me ask you this:

At no point have I seen any reference to the FDIC in your testimony or that of Mr. Heimann. Has the FDIC participated in and is the FDIC indeed also monitoring this $800 million loan arrangement among various financial institutions?

Mr. HEIMANN. Perhaps I can be helpful there, sir. As the information was developed, it was transmitted to the FDIC, but it was perfectly clear at the outset that loans that were Hunt-related, if you will, tended to be in a certain group of institutions, larger institutions, which were not directly the charge or the responsibility of the FDIC, either falling under the Comptroller's Office or the Federal Reserve, the member banks, but information was shared with them.

There was one area, however, that was of particular importance to the FDIC. The Hunt family, directly or indirectly, has some control or interest in smaller financial institutions, banks. Those banks were FDIC banks and were looked at immediately by the FDIC through the examination process in order to determine if there were any relationships of any sort or loans——

Mr. ST GERMAIN. Extensions of credit.

Mr. HEIMANN. So that wherever those institutions were involved the FDIC was involved.

In addition to that, of course, in the sharing of information between the financial regulators, whatever we had we gave to the FDIC, as they gave back to us.

Mr. ST GERMAIN. Indeed though they don't regulate many of these banks. Nonetheless, they hold the insurance.

Mr. HEIMANN. The information was shared, certainly.

Mr. ST GERMAIN. I say to both of you that I am sure you realize that at this point in time we will be revisiting this. I will be asking my staff to contact you so that they indeed can look over some of these examination reports relevant to some of the questions I have been asking this morning because I think it is within the purview and it is important to us to be informed as to what has occurred here and in what manner this has been handled, and we will be doing this under the supervision of another subcommittee of this Congress.

I don't think that comes as a surprise to either one of you.

Mr. HEIMANN. Always delighted to work with you.

Mr. ST GERMAIN. And we look forward to joining with you. I thank my colleagues on the committee for their indulgence.

I would just like to make one last statement, Mr. Volcker, and that is that I have an article here, "Lenders face decisive role in credit squeeze campaign," dated March 22, 1980.

Mr. VOLCKER. What took place?

Mr. ST GERMAIN. "Lenders face decisive role in credit squeeze campaign." It is an article on economic affairs. This is from the Congressional Quarterly. There is a nice picture of Chairman Volcker here and a quote, "Looking into the future, the less fiscal restraint you get, the more the burden falls back on us."

And then you are being quoted here as saying:

> We have attempted to even out the impact, Volcker noted, but he later added, I don't want to give the impression that credit controls are a bed of roses for anybody.

I would say perhaps not you, but as far as the Hunts are concerned, they come up smelling like roses on this.

Mr. **Volcker.** I don't agree with that.

Mr. **St Germain.** I am sure you don't.

Mr. **Volcker.** Let me just emphasize that this problem arose in the initial speculative activity. There are obviously sizable losses involved, but that speculative activity was not essentially financed by credit. That is the nature of the beast.

Mr. **Rosenthal.** Mr. Levitas.

Mr. **Levitas.** Thank you, Mr. Chairman.

I hope I won't go over some territory that has already been covered, but there are some specific facts that I would like to get into, if possible. You, Mr. Volcker, talk about the present negotiations that are underway, which are to restructure the outstanding indebtedness.

Mr. **Volcker.** Right.

Mr. **Levitas.** What information do you have as to the nature of that outstanding indebtedness in terms of what banks, what creditors, and the amount of the outstanding indebtedness with respect to each of the banks or other creditors?

Mr. **Volcker.** In general, these credits have fallen in, I suppose, three categories. There is some direct lending connected with the silver business to the Hunt family by banks.

Mr. **Levitas.** How much is that?

Mr. **Volcker.** Oh, between $100 and $200 million maybe, in that area. There is lending or has been lending by the banks, as we just discussed, through brokerage houses or commodity dealers, that went ultimately to the Hunts, whether the banks knew about it or not; that was certainly a larger figure.

Mr. **Levitas.** What is that?

Mr. **Volcker.** I am really uncertain about that; I don't know. I can't identify all of that.

The financing of the brokerage houses or commodity dealers themselves to the Hunts was, I would guess, in the $500-million range. I am giving you an estimate from off the top of my head; some of that was financed through banks and some of it was not.

The direct lending I refer to is U.S. bank lending. There is additional foreign bank lending, and the remainder would be, in effect, indebtedness on open contracts where it is not a negotiation of a bank loan, but an indebtedness growing out of the contract itself.

Mr. **Levitas.** And that approximates $800 million?

Mr. **Volcker.** The grand total of that just for the Hunts certainly was larger than that at one stage.

I believe it would still be larger than that, but every last piece will not necessarily be restructured. That excludes, I believe, the Hunt participation with foreign interests that were engaging in silver speculation, too. That is why there is uncertainty about the total.

Mr. **Levitas.** I take it that the individual loans and certainly the indirect loans made through brokerages were secured at least in part by silver contracts.

Mr. **Volcker.** Yes. Not all the personal loans were secured by silver, I should add, but basically you are correct.

Mr. **Levitas.** Do you know of any financial institution which had more than, say 15 percent of the aggregate of these loans?

Mr. **Volcker**. If any financial institution includes brokerage houses, yes.

Mr. **Levitas**. Do you know of any banks that had more than 15 percent of these loans?

Mr. **Volcker**. No.

Mr. **Levitas**. I am sorry, I didn't hear your answer.

Mr. **Volcker**. No; I am answering from memory, but I think that is correct.

Mr. **Levitas**. Does the Federal Reserve in fact know the percentage and amount of loans to the Hunts directly or indirectly which were with all of the banks involved?

Mr. **Volcker**. You are never sure that you know it all. I think we have a pretty good idea at this point. What we don't know is precisely how all the loans of the brokerage houses or the commodity dealers might themselves have been financed, because it doesn't appear in a Hunt name on the bank's books and there is a lot of other financing that goes on for these institutions as well.

Mr. **Levitas**. Those banks that were participants in this lending to the Hunts directly or indirectly, can you furnish the committee a list of the banks that you do know of and the amount of lending that they were involved with?

Mr. **Volcker**. I don't think that is really possible, Mr. Levitas. I think that would fall under the normal rules of confidentiality of our examining relationships with those banks. I can give you some general idea of the sort of information that you have been asking about, but I don't think it is appropriate for me to identify particular banks and particular loans to particular people.

Mr. **Levitas**. Mr. Chairman, is that your position based on advice of your counsel, or is that just your initial personal responsibility?

Mr. **Volcker**. It is both. I think that has been a longstanding attitude. In fact, the law, as you know, carefully protects examination reports, and I think it would be very unfortunate to create precedents if information involving the private commercial relationship that comes to our attention is made public.

We wouldn't get information for very long if we did that.

Mr. **Levitas**. I am somewhat familiar with the statutory restrictions on confidentiality of bank examinations. In fact I think several years ago this subcommittee was involved with the supervisory agencies in obtaining certain of that information in connection with the Franklin and some other matters, but what about information that is available to you and which you no doubt have from sources other than bank examinations, which is not so protected?

Mr. **Volcker**. Our basic information comes under that framework. Some of it comes from other agencies that I believe would have similar restrictions so far as brokerage houses and commodity dealers are concerned. I think we can try to provide you what information would be useful of the sort that you were asking about, some idea of the number of banks, the relative size, and that sort of information.

[The information follows:]

INTERIM REPORT ON FINANCIAL ASPECTS OF THE SILVER MARKET SITUATION IN EARLY 1980

Introduction

The purpose of this report is to set forth the facts and information currently available to the Federal Reserve in connection with the financial aspects of the sharp fall in silver prices that occurred in the late winter and early spring of 1980. Of particular concern in connection with this Interim Report are the questions pertaining to the extent and nature of the use of bank credit in connection with the overall episode, especially in the context of the Federal Reserve's credit restraint program. It appears clear that a combination of events — including the general unsettled and speculative atmosphere surrounding severe inflation -- did produce a situation which had the potential for creating serious problems for individual financial institutions and for the financial markets generally. Many of the larger questions, including the underlying issues of the nature and extent of regulatory or legislative actions that might prevent a similar occurrence in the future, will be answered more fully in a further report.

The episode as a whole, and specifically the involvement of the Hunt and Hunt-related entities, is extremely complex, involving a large number of institutions, some with broad public ownership, others closely held; some domestic, others foreign or foreign-related; some financial, others nonfinancial. Also, the credit and credit exposures that ultimately emerged in the wake of the sharp drop in silver prices took a number of forms. There were direct "conventional" bank loans by both U.S. and foreign based banks to the Hunt and Hunt-related interests — most of which were collateralized by silver. There were bank loans -- both domestic and foreign-related -- to brokers and commodity dealers and there were broker loans, financed by internal sources of funds, to the Hunts. There was also credit extended by brokers and other corporate entities in the form of unmet margin calls on Hunt forward and future contracts in silver. Finally, there were bank loans, broker loans and unmet margin calls associated with the International Metals Investment Co., Ltd. (IMIC). The obligations in the United States of that venture in which the Hunts own a substantial interest are, as we understand it, guaranteed by the Hunts. Because of the many entities involved — including foreign entities — and the complexity of the transactions, all of the facts of the case may never be known with precision.

In light of the dimensions of the case, this report traces developments and events in chronological order and provides specific information regarding credit-related aspects of the episode.

1. Events prior to March 26

In the late summer and early fall of 1979, the Federal Reserve had been concerned about developments in commodity markets and particularly the apparent speculative attitudes that had driven commodity prices, and particularly precious metals prices, markedly higher. This concern was reflected in the Federal Reserve's October 6 policy changes, the announcement of which called specific attention to speculative tendencies in commodities markets. At that time, the Federal Reserve requested banks to avoid making speculative loans. The request at that time was in the form of "moral suasion" and did not have the backing of either regulation or specific reporting requirements. The message was contained in a letter which was sent to all U.S. banks, branches and agencies of foreign banks operating in the U.S., and to foreign central banks. In the ensuing several weeks, the prices of commodities in general eased. The price of silver stabilized at about $16 to $17 per ounce — up from the level of $10 to $10.50 that had prevailed at the end of August.

In late November and early December, the silver price again rose sharply, as did some other commodity prices. That renewed outburst of price increases seemed, at the time, to be related to unsettled conditions growing in part out of heightened concern about oil prices and supplies and international political events. In this time frame, however, there were press reports and market rumors of irregularities in the silver market. Because of this, and because of the damaging impact on inflation and inflationary expectations of a renewed outburst of speculatively driven price increases in precious metals, the Federal Reserve made inquiries about the silver situation to the Commodity Futures Trading Commission. While we did not obtain any significant information beyond that generally available in the press, we were left with the impression that initiatives of the CFTC and the exchanges had the situation under close review. The price of silver continued to climb sharply, reaching an intra-day high of $50.36 on January 18. In retrospect, it is clear from published reports of the CFTC, that by this time the Hunts had and apparently were continuing to acquire massive positions in physical silver, silver futures and silver forwards.

During late 1979, and particularly in January 1980, the exchanges took a number of steps in the silver market, including imposing higher and graduated margin requirements, position limits, and limits on trading.

Throughout this period, the evidence available to us suggests that bank credit was not a major factor in connection with the acquisition or maintenance of silver positions by Hunt and Hunt-related interests. Indeed, the Hunts had apparently acquired a large amount of silver and silver positions prior to the sharp rise in prices and, to an unknown extent, may have pyramided those positions by using daily cash payouts on existing positions to acquire still larger positions when the silver price was rising. At this point, we have no evidence as to whether individuals and institutions on the other side of the market were forced to finance their margin calls (which were paid out to the Hunts) via bank borrowing. However, it seems fair to assume that industrial firms that were short sellers of silver may have used existing bank lines to help meet the cash flow needed to make such payments. For such market participants, such bank loans, to the extent they occurred, would seem wholly appropriate. And, in those circumstances a refusal to lend to the shorts in the market by banks would have added still further upward pressures on the price of silver. In any event, the pattern of behavior on the upside of the episode is an area of continuing investigation.

The price of silver broke sharply lower in late January, but then stabilized in the $30 to $36 range until early to mid-March when the price again broke sharply, falling to a low of $11.10 at the close of business on March 27. Since that time, the price has fluctuated in the $12 to $16 range, even though it appears that a substantial volume of silver was sold into the market in late March and April. There remains, of course, the question of who acquired the silver that has been liquidated and for what purpose.

From the information we have been able to compile, it appears that substantially all of the bank and other credit accumulated by the Hunt interests related to silver was incurred in the first quarter of 1980 and most of that was incurred beginning in early February through the end of March. This would suggest that such funds may have initially been used in some limited way to meet higher initial margin requirements and, to a much larger extent, to meet maintenance margin calls as the price of silver dropped. At the time the Federal Reserve had no direct knowledge of the size of the Hunt positions or of the fact that they were financing margin calls by borrowings of any kind.

Beginning at mid-day March 26, when Chairman Volcker was first notified of the failure of the Hunts to meet margin calls, the Federal Reserve, in cooperation with the Office of the Comptroller of the Currency, undertook a series of special initiatives aimed at fact finding and analysis of the situation. Extensive discussions were held with other government agencies and officials aimed in part at initiating special inspections of involved brokers by the appropriate government agencies and the various exchanges. Special examinations of a number of banks were undertaken by the Federal Reserve and the Comptroller of the Currency which included sample verifications of silver warehouse receipts and silver. All involved banks were contacted to obtain information regarding loans to the Hunts; and all involved banks have been asked to provide written explanations of why such loans were made in the presence of the Federal Reserve request to avoid speculative lending; and, for the first time, under residual power contained in the International Banking Act, special examinations of branches and agencies of foreign banks were undertaken by the Federal Reserve.

Despite the scope and intensity of those efforts — which are continuing — there are many aspects of the case, particularly those related to overseas activities and those relating to the circumstances that permitted the situation to develop in the first instance, that are still unanswered. However, from those investigations, it quickly became apparent that during February and March, the break in the price of silver gave rise to a substantial amount of borrowing by the Hunts. Credit to the Hunts, as it developed, took several forms which are described below. In looking at these data, it should be emphasized that in many instances, the data supplied is based on information gathered from a variety of sources and is therefore subject to some margin of error.

A. Direct Loans of U.S. Banks to the Hunts ($195 Million)

We have been able to account for about $150 million in direct silver-related loans to the Hunts by U.S. banks. These loans were secured largely by silver and to a much lesser extent by Hunt properties. An additional $45 million in borrowings secured by assets other than silver were taken down in March and early April. We do not know to what extent these funds were or were not used to meet silver-related obligations but the timing of the loans suggests that they may have been used for that purpose. Of the overall total $5 million was outstanding as of August 1979; $50 million was taken down in the first half of February; $95 million in the first half of March; and $45 million in the second half of March and the first week in April. The rates of interest on the loans ranged from prime plus 1/4% to prime plus 1%. Of the $195 million, $15 million was repaid on April 1; and $100 million was repaid on April 8, from funds advanced by banks that will be part of the $1.1 billion syndicated loan to Placid Oil. Thus, $80 million is still outstanding and of that total, we now expect that $35 million will be rolled into the $1.1 billion credit line.

B. Loans by U.S. Banks through Placid Oil Company ($115 Million)

Between mid-March and early April, we have reason to believe Placid Oil loaned or advanced at least $110 million to the Hunt brothers. While we do not have full details on these loans, it does appear that most of these advances may have been funded by loans from U.S. banks to Placid. For example, $50 million in bank loans were extended to Placid in mid-March and another $65 million on April 1. These loans were at rates of prime plus 1/2% to prime plus 1%. The banks loans have since been reduced to $80 million which presumably will be repaid or rolled into the new syndicated loan to Placid.

C. Direct Loans by U.S. Branches and Agencies of Foreign Banks to the Hunts ($230 Million)

As we now understand it, direct loans by foreign banks to the Hunts secured by silver peaked at about $230 million in mid-March. These loans appear to have been funded out of the U.S. branches of the foreign banks and thus would seem to qualify as "domestic" credit. Of the total, $65 million was taken down in 1979; $50 million in the first half of February; $68 million in the second half of February; and $47 million in the first half of March. The rates of interest were 3/4 of 1% to 1% above prime. The loans have been reduced by about $65 million from their peak level, in part by advances to Placid Oil by U.S. banks in anticipation of the large syndicated loan to Placid/Hunt. The balance due now totals approximately $175 million and presumably will be repaid by the proceeds of the new syndicated loan to Placid.

D. Indirect Loans by U.S. Banks ($260 Million)

There were also about $260 million in silver-related loans by U.S. banks to a brokerage house, the proceeds of which were then made availabe to the Hunts by the brokerage house — presumably to meet margin calls. Some of these loans were advanced under existing lines of credit and were secured by silver. The interest rates to the brokerage house were generally at prime. From our discussions with the lending banks, it appears that most of the banks had the impression that they were providing funds to the broker against fully hedged positions and certain banks indicated that initially they were not even aware that funds advanced were used to support Hunt silver positions. One of these banks holds both silver and gold bullion as collateral. Of the total, $33 million was advanced in 1979; $26 million in January of 1980; $143 in early February; and $60 million during the last week of February. Most of these loans were substantially reduced or liquidated in early April by the proceeds from the sale of collateral. Of the indebtedness remaining after the silver liquidations, about $34 million of the balance will be reduced from the settlement of silver already sold for future delivery, which will leave approximately $10 million outstanding.

E. Indirect Loans and Credits by Foreign Banks and U.S. Branches and Agencies of Foreign Banks ($215 Million)

It now appears that about $215 million was indirectly supplied to the Hunts by foreign banks and their branches and agencies in the U.S. About $115 million of this was in the form of silver backed loans to brokers (the proceeds of which were advanced to the Hunts). These loans (a small part of which were actually funded by a U.S. bank) appear to have been funded out of the U.S. agencies and branches of the foreign banks and thus are "domestic credit." And, up to another $100 million in obligations was in the form of margin calls on silver forwards at the overseas offices of foreign banks. At this time we do not have detailed information on the terms and timing of these obligations. Of this overall total, about $100 million remains outstanding and the remainder was paid off by funds advanced by U.S. banks in anticipation of the Placid syndicated loan.

F. Direct Broker Loans ($100 Million)

We understand that brokers also supplied the Hunts with silver backed loans in excess of $100 million from their own funds. We believe about $75 million of such loans are still outstanding and will be repaid from the proceeds of the Placid/Hunt syndicated loan.

G. Obligations of the International Metals Investment Co., Ltd. (IMIC) ($200 Million)

As noted earlier, the Hunts own a substantial interest in IMIC and fully guarantee certain of that company's obligations in the United States. As we understand it, IMIC obligations in the U.S. secured largely by silver include: (a) a $25 million bank loan made on October 10, 1979; (b) a broker loan of about $25 million that was reportedly made sometime in early 1980; and (c) as of early May about $150 million in various broker-related obligations. The latter obligation may have been considerably larger early in April and is being reduced by liquidations of silver futures and forwards. (We do not know the nature and extent of IMIC obligations or positions abroad.) All of these U.S. obligations are secured largely by silver but we do not have details on the precise time when such obligations were incurred. The broker loan and the other U.S. obligations of IMIC to brokers presumably will be paid off by the proceeds of the syndicated loan to Placid Oil.

H. Obligations to Nonfinancial Concerns ($450 Million)

We know of one major Hunt obligation to a nonfinancial concern (The Engelhard Mineral and Chemicals Corp.) that arose out of Hunt forward contracts to buy silver at prices well in excess of the price of silver at the time of delivery. We understand that those contracts entailed a gross obligation of about $700 million which was only partially secured by silver and/or other collateral held by Engelhard. Because of these circumstances, settlement of the contracts on March 31 would have required the Hunts to make a cash payment to Engelhard that is estimated to have been in the range of $400 to $450 million. This obligation, as noted below, was settled by an exchange of assets.

To summarize, on or about March 31, we have been able to identify Hunt nd Hunt-related obligations associated with silver as follows:

Direct Loans by U.S. Banks to the Hunts	$ 195
Loans by U.S. Banks through Placid Oil Company	115
Direct Loans by U.S. Branches and Agencies of Foreign Banks to the Hunts	230
Indirect Loans by U.S. Banks	260
Indirect Loans and Credits by Foreign Banks and U.S. Branches and Agencies of Foreign Banks	215
Direct Broker Loans	100
Obligations of the International Metals Investment Co., Ltd. (IMIC)	200
Obligations to Nonfinancial Concerns	450
Total	$1,765

In a number of instances, particularly in respect to obligations of IMIC and the obligations to foreign banks, we do not know, with precision, the timing and other details as to when the obligations were incurred. However, by making some assumptions about timing in these areas, we have pieced together a week by week estimate of debts incurred by various classes of institutions. These estimates suggest that the level of total obligations increased sharply first in late January and early February. This surge in borrowing broadly coincides with the initial drop in the price of silver for its high of about $50 per ounce to a price in the area of $35 per ounce. The Hunt borrowings trended higher during February but then moved sharply higher in mid to late March when the price of silver declined to the $12 range.

Looking just at bank credit, it appears that total bank credit associated with the episode probably peaked at $1.0 to $1.1 billion level in late March or early April. Of that total, it appears that $100 million was funded from abroad so that at the peak, $900 million to $1 billion of domestic bank credit was involved. Of that total, about $125 million dates back to 1979. The major increases in domestic bank credit occurred in early February when such loans rose by $350 million and between March 6 and April 1 when the aggregate domestic loans rose by more than $250 million. For the months of February and March combined, the use of domestic bank credit in connection with this situation increased by $800 million. By contrast, total business loans and total bank loans rose by $6.2 billion and $9.3 billion on a nonseasonally adjusted basis, respectively during this two month period.

There were a total of 12 U.S. banks, 4 branches and agencies of foreign banks and 1 foreign bank that, as of early April, were significant silver-related creditors of the Hunts. In eight out of 12 cases involving U.S. banks, the amounts of loans outstanding were relatively modest and were, in most cases, in the form of loans to brokers. Five of the eight banks with such loans used the discount window on at least one day during February/March. However, the patterns of discount window use by all of these institutions are not unusual during the period particularly in the light of overall money market conditions and the modest size of the Hunt loans.

The four banks that were somewhat larger creditors to the Hunts all used the discount window during February/March; one bank on one occasion; one bank on two occasions; and two banks on four occasions. Most of these borrowings were on Tuesday or Wednesday, and therefore were associated with ends of statement weeks. In the case of two of the four banks, the timing of the use of the window relative to the timing of the Hunt loans makes it clear that there is no -- or at the very worst a very indirect -- relationship between the two. In the case of one of the remaining two banks that were larger creditors to the Hunts, the institution did borrow several times during a statement week in early March. At that time, the institution was not increasing its loans to the Hunts. Thus, while those borrowings were relatively large, amounting to $80 million on average for the statement week, they do not appear to be directly related to Hunt lending. Finally, in the case of the remaining bank, there is an approximate coincidence of timing in two statement weeks between discount window borrowings and Hunt loans in the second half of March. In both cases the borrowings were for one day only on a Wednesday (the end of the statement week) and the amounts were not unusual. On a daily average basis, for the three weeks in question, the borrowings amounted to about $25 million which, as a matter of pure arithmetic, may be said to have funded part of a Hunt-related loan at the institution in question. However, neither the Hunt loan nor the timing or amount of the discount window borrowings were not out of keeping with the size of the bank. In summary, therefore, we can find no evidence of unusual activity at the discount window during this period that can be related to the silver market situation or to the Hunts.

As the amount of Hunt obligations became apparent to the Federal Reserve in late March, the immediate concern of the Federal Reserve and that of other government agencies related to the potential implications of the situation for the financial markets generally. Those concerns reflected not only the situation in the silver market but the uneasiness that characterized markets in general at that time. While all of these obligations were secured, the collateral in most cases was silver. And, as the price of silver declined, the margin on such loans became very thin and in some cases the value of the collateral actually fell below the amount of the loans. Thus, in the extreme, the creditors were faced with the prospect of recouping their funds by forced liquidation of silver that could, from their viewpoint, further undermine the value of the collateral and accentuate their risk. And, in these circumstances, there was always the threat that a localized problem could quickly spill over to affect other institutions and markets.

As Chairman Volcker has indicated in his Congressional testimony, during the period immediately after the sharp break in the silver price, the Federal Reserve, the Treasury, the SEC and the CFTC spent considerable time and effort trying to ascertain the facts of the case — which while reasonably clear now — were far from evident at that time. Subsequently, the price of silver — which is a world price — did stabilize on Friday, March 28, thereby halting the erosion of the value of the collateral being used to secure most of the obligations referred to above.

2. The March 28 - April 5 Interval

In the days immediately following March 28, some of the edge was taken off the situation by two developments: first, agreement was reached for a settlement of the Hunt indebtedness to the Engelhard firm referred to above; and second, the continued stability of the silver price at $12 to $14 per ounce permitted other creditors to begin to liquidate silver in an orderly fashion and thereby eliminate their exposure. For example, one brokerage firm was apparently able to sell a significant amount of the silver it held against its own bank loans and thereby repay most of that bank credit in early April. It appears that such silver sales were undertaken both in the U.S. and abroad.

The Hunt/Engelhard transactions which were negotiated on Monday, March 31, have been the subject of much confusion. As noted earlier, this situation grew out of several substantial forward contracts entered into by the Hunts and Engelhard in mid-January 1980. Under these contracts the Hunts were to take delivery on physical silver over the period January 31 to July 1. The contract prices generally reflected market prices in mid-January when the transitions were made and some deliveries were made prior to the sharp drop in silver prices in late March.

Late on Friday, March 28, the Federal Reserve learned of these large forward contracts. Settlement on most of them was due after the weekend, with no apparent prospect for payment, and the collateral held by Engelhard was far short of the total obligation. Engelhard, while itself in a strong profits and asset position, felt they might be faced with a decision on Monday to sue the Hunts for payment, forcing probable bankruptcy and possibly triggering massive liquidation of silver positions to the peril of all creditor institutions (and indirectly placing in jeopardy the customers and creditors of those institutions in a financial chain reaction). The alternative, as the company saw it, was to negotiate with the help of some banks a credit to the Hunts or intermediaries that could provide time for repayment and avoid forced liquidation of silver in an already nervous, depressed market. On March 29, the Federal Reserve was informed in a very general way that the parties intended to explore such an approach to resolving the Engelhard situation. In that time frame the question immediately arose as to whether such a credit would be considered "speculative" within the context of our credit restraint program.

After informing other government agencies of this development and considering with them all the implications of the matter, Chairman Volcker interposed no objection to Engelhard pursuing whatever negotiations the company felt essential to protect its own position, but made it quite clear that the net result should not be to free funds for renewed speculative activity by any of the parties. In view of the wider implications, Chairman Volcker asked to be kept informed of the progress of any negotiations and the nature of any implications of their negotiations for the market and for speculative activity.

While fulfilling a speaking engagement before the Reserve City Bankers Association meeting in Boca Raton, Florida, that weekend, Chairman Volcker learned that the Engelhard and Hunt interests would together approach a group of banks with a refinancing proposal late in the evening on March 30 in Boca Raton. While the nature of that proposal was not known to Chairman Volcker, he again asked to be kept informed because of the potential implications for the silver and financial markets. Subsequent to the negotiation (and well after midnight), he again was informed that the banks had, or planned to, reject the proposal by the Hunts and Engelhard on business grounds. Neither Chairman Volcker, nor any other government official, either instigated or guided those negotiations.

Following the rejection of the proposal to consolidate and restructure the Hunt silver indebtedness, negotiations proceeded through much of the night directly between the Hunts and Engelhard. The results of those negotiations, involving in part the transfer of certain oil properties owned by the Hunts to Engelhard, became known to Chairman Volcker in the morning of March 31, and were announced the same day. This settlement which essentially involved an exchange of assets and involved no credit, have the effect of fully clearing up all outstanding contracts and obligations of the Hunts to Engelhard. That transaction has not yet been consummated in part because the exchange of assets required the release of nonsilver assets that had been securing bank loans and because of the need to obtain the approval of the Canadian Government for the transfer of certain oil leases in Canada to Engelhard.

In the following days, the Federal Reserve and other agencies continued efforts to develop more comprehensive information on the extent of Hunt and Hunt-related obligations and to appraise the potential vulnerability of banks and other intermediaries. While very large amounts of credit remained outstanding, those creditors who had appeared to be in the most vulnerable position appeared to have extricated themselves, albeit with some losses (some of which, at least, have since been recouped). Together with representatives of other agencies, the Federal Reserve turned its attention to ways of developing means of avoiding extreme speculative episodes of this kind in the future, with all their implications for the stability of financial institutions and financial markets.

3. The Period from April 5 to the Present

The large syndicated bank loan to Placid Oil which has been the subject of so much attention first came to the attention of the Federal Reserve on Saturday, April 5, when the general thrust of the concept was relayed to Chairman Volcker in a telephone call from a senior official of one of the lead banks. From that discussion, the Federal Reserve concluded that the banks and other creditors had, by then, more fully appraised their overall exposure to the Hunt interests in the context of the nature and amount of collateral available in connection with those existing credits.

The concept, discussed in general terms at that time and elaborated in a later call, entailed a method of restructuring the Hunt silver indebtedness in a manner that would greatly strengthen the security position of creditors with outstanding silver loans or contracts and facilitated the release of certain collateral by banks. In the process, new creditors would in some instances replace existing creditors, while other creditors would essentially exchange old loans with new. The new bank loans would be to and secured by the assets and earning power of perhaps the strongest of the Hunt-related companies, the Placid Oil Company. Control over the silver and silver contracts, with appropriate safeguards, would pass into the hands of that same company. Silver-related loans to the Hunts would be paid off. The immediate result would be to protect more securely the interests of existing Hunt silver creditors, bank and nonbank. In doing so, the risk associated with such positions diminished with obvious implications for the institutions and the markets generally. That result, in itself, was not, and is not, contrary to the broad public interest in the stability of financial markets and institutions.

At that time, and in a general way, Chairman Volcker made it clear that his primary concern about any such loan would be that it not free funds for renewed speculation and that any such transaction would have to provide adequate safeguards in that regard. It was also indicated that such a loan would not receive special consideration within the framework of the Federal Reserve's 6 to 9 per cent guideline on loan growth. Chairman Volcker again asked to be kept informed of developments. Other government officials were informed of their discussions.

On Thursday, April 10, at the request of the banks, a meeting was held at the Office of the Comptroller of the Currency at which time further information concerning the negotiations was made available to the staffs of the Federal Reserve, the Federal Deposit Insurance Corporation and the Comptroller. At that time, it was clear that the negotiations were proceeding along the general lines described above. But it was also apparent that the transaction was far from complete. There was clear evidence that the banks were seriously endeavoring to structure into the loan agreement the kinds of restrictions on speculation that Chairman Volcker had mentioned in his earlier conversation. The Federal Reserve again asked to be kept informed of the progress and status of the negotiations and subsequently suggested that at the appropriate time information about the loan and the restrictions should be provided to the Federal Reserve in writing. In the ensuing week the negotiations proceeded between the parties. At no point in the process was the Federal Reserve or any government official a party to such negotiations. Our only contact with the negotiations was via the officials of the lead banks and was directed solely at securing the appropriate restrictions on speculation.

The following week, the lead banks requested a meeting with the Federal Reserve to discuss further the specifics of the restrictions and limitations on speculation that would be part of the transaction partly so that those responsible for drafting the agreement understood our concerns first hand. Officials of the lead banks and attorneys representing the various parties met with Chairman Volcker and staff on Friday, April 18, at which time specific language concerning such restrictions was discussed. At that time, it was also made clear that the loan agreement would have to provide language to ensure the orderly liquidation of the remaining Hunt silver.

During the following several weeks the parties to the prospective transaction continued their private negotiations and the Federal Reserve staff was kept generally apprised of the status of the matter. In those negotiations between the banks and the Hunt interests, the nature and dimensions of the prospective transaction evolved further. As we now understand it -- and recognizing that the arrangement is not yet complete -- the essentials of the transactions are as follows:

(a) A syndicate of 11 domestic banks and 2 foreign banks would establish a line of credit to Placid Oil (which is owned by the Hunt family trusts but not by the Hunt brothers) in the amount of $1.1 billion. The credit line would be fully secured by substantially all of the oil and gas properties of the Placid Oil Company thereby isolating the creditors from vulnerabilities associated with a further fall in the price of silver.

(b) The Hunt brothers and a newly formed wholly-owned subsidiary of Placid would form a limited partnership. The Placid subsidiary would be the sole general partner and the Hunts the limited partners. The Hunts could exercise no control or influence over the partnership. The proceeds of the loan would fund Placid's contribution to the partnership. The remaining

Hunt silver and certain of their other assets would be transferred to the partnership, subject to existing Hunt silver loans. Thus, while the creditors are protected from a fall in the price of silver, the Hunts and the partnership are not.

(c) Over time, and with the assistance of independent third party expertise, the silver (and, if needed) other assets contributed to the partnership by the Hunts will be liquidated and the proceeds of such liquidations would be required to be distributed to the partners to pay the interest and principal on the loan to Placid. The pressures associated with servicing this debt, to say nothing of repaying its principal, should help ensure that such liquidations will occur in a reasonable time frame.

(d) The loan will be guaranteed by all material Placid subsidiaries and by the Hunt brothers, and the Hunt guarantee will be secured by liens on substantially all assets of the Hunt brothers. The loan will be further secured by the general partner's right to receive distribution from the partnership.

(e) The agreements relating to the partnership and the Hunt guarantee provide that the Hunts and all related entities cannot make any new investments in securities (except appropriate money market instruments) or take any position in commodities or any other futures position for any speculative purpose or otherwise while the Placid loan is outstanding or the partnership is in existence except investments necessary for the prudent operation of the farm, ranching and sugar businesses owned by the Hunts. Furthermore, the Placid loan agreement prohibits Placid, while the loan is outstanding, from engaging in any similar speculative activity including using the proceeds of the loan to finance acquisitions that would be inconsistent with the intent and purpose of the credit facility.

(f) Special accounts, subject to independent audits by a major public accounting firm, will be established to control all such funds.

(g) Records regarding the use of funds, the liquidation of assets, and other relevant aspects of the transactions of the Hunts and the Partnership will be available to the Federal bank regulatory agencies.

As noted above, the line of credit under the agreement will be $1.1 billion; however, it is presently estimated that the amounts to be actually advanced will total about $950 to $990 million.

In order to reconcile the prospective payments of $950 to $990 million with the total obligations of $1.765 billion noted earlier, it must be kept in mind that the estimate of $1.765 billion has been significantly reduced by (a) the Hunt/Engelhard exchange of assets ($450 million) and (b) the liquidation of silver collateral and silver positions by brokers which, in turn has permitted the repayment of bank loans and the reduction of the brokers own direct exposure to the Hunts. While we do not have information on all of these latter transactions, the information which is available suggests that such liquidations probably have reduced the total Hunt obligations by at least $300 million and perhaps by as much as $400 million since late March. Other things being equal, these developments would place the current level of the Hunt obligations in a range of $900 million to $1 billion which is not out of line with the payments we now expect will be made from the $1.1 billion credit facility to Placid Oil.

However, in looking at these prospective payments, it must also be kept in mind that beginning on April 8, a group of the banks that comprise the syndicate that will make available the $1.1 billion credit facility to Placid advanced about $300 million to Placid. In turn, Placid used those funds to pay off some of the then existing creditors of the Hunts. Thus, these advances by U.S. banks to Placid have already had the effect of restructuring some of the Hunt obligations as of March 31. After making allowance for these developments, we anticipate — in very approximate terms — that the loan takedowns under the $1.1 billion credit facility will be used in the following manner:

(a)	Repayment of interim U.S. bank loans to Placid Oil made in anticipation of the $1.1 billion credit facility which in turn had been used to repay (1) $100 million in direct U.S. bank loans to the Hunts; (2) $50 million in indirect loans to Hunts (via brokers) made by U.S. branches of foreign banks; (3) almost $100 million in obligations to foreign banks; and (4) $50 million in miscellaneous obligations to brokers and others.	$300M
(b)	Repayment of other advances by Placid Oil which should permit Placid to repay $80 million in outstanding silver secured loans to U.S. banks.	$110M
(c)	Repayment of direct Hunt loans by U.S. branches and agencies of foreign banks.	$175M
(d)	Repayment of indirect loans to Hunts (via brokers) made largely by U.S. branches of foreign banks.	$100M
(e)	Repayment of remaining Hunt and IMIC broker loans and obligations.	$260M
(f)	Repayment of direct loans by U.S. banks to Hunts	$ 35M
		$980M

The difference between the anticipated takedown of $950 to $990 million and the total credit facility of $1.1 billion reflect, in part, a cushion that will cover any shortfall arising from liquidations of remaining forward or future positions and/or the sale of assets. That cushion may never be used and, to the extent it is, those disbursements are subject to the same terms and conditions governing the overall agreement.

The amount of this credit is, of course, very large and the circumstances under which it arose are clearly extraordinary. However, looked at in its totality, the transaction may fairly be viewed as a complex debt restructuring in which current and prospective creditors are seeking to strengthen their positions and one in which the debtors are seeking to consolidate obligations and insulate themselves from any of several eventualities that could result in further needs for cash. The credit is, and always has been, a strictly private transaction in which business, credit and other judgments have been made by the parties themselves with no guidance, suasion or other efforts by the Federal Reserve to influence the nature and the terms of the credit other than those related, to the limitations on speculation. And, while it should be clear that the credit, taken in its totality is, in fact, a restructuring of existing obligations rather than the creation of new credit, total bank loans will increase somewhat under the credit because they will be, in some instances, substituted for existing credit supplied by brokers from their own funds. Finally, by virtue of the fact that the debt restructuring strengthens the position of creditors, it is not contrary to the broad public interest in the stability of financial markets and institutions.

The credit also has the result of stabilizing, to some unknown extent, the financial position of the Hunts themselves. We do not know the financial position of the Hunt brothers when allowance is made for the fact that the brothers do not have access to the principal amount of the family trusts. It is clear, however, that they have assets and relationships that have permitted this transaction to be put together to the satisfaction of the prospective creditors. In the absence of the Federal Reserve Special Credit Restraint Program the credit may well have been arranged and put in place without any prior knowledge of the Federal Reserve or other government officials. Looked at in that light, the fact of the Credit Restraint Program has permitted the Federal Reserve to insist on the limitations on speculation which are a part of the transaction and which are in the public interest.

In short, the $1.1 billion restructuring of debt is the result of an unhappy chain of events that had occurred earlier and, in the extreme, posed a serious threat to certain financial institutions and to the markets generally. Thus, the focus of public policy should be on the conditions and circumstances in the fall of 1979 and in early 1980 that permitted the situation to develop in the first instance. It is to that end the Federal Reserve, in consultation with other government agencies and representatives of the private sector, has now turned its attention.

Mr. **Levitas**. The reason this becomes particularly relevant to me is that when I go to the next series of questions about the restructured loan, I think it becomes significant as to who is being restructured and on what terms, and unless we know where we are starting from on this restructuring, as you categorized it, we are not in a position to make any judgment as to that.

Let me move into that next series of questions about the restructuring of the loan. You stated in answer to a question I believe by Mr. Rosenthal, Chairman Rosenthal, that the interest rate on this restructured loan would be a market rate. I take it that a market rate presumes there is a market. There is no market so far as I am aware for loans of the magnitude to individuals from commercial banks of what we are talking about.

Mr. **Volcker**. There are very large loans to commercial firms in the banking system, as you well know, and this loan is being structured, so far as the banks are concerned, as a loan to Placid Oil Co., which is a large and profitable enterprise.

Mr. **Levitas**. Is it your understanding that the interest rate on this restructured loan arrangement that is being negotiated will be above what is now the prime?

Mr. **Volcker**. I hate to get into this area, which seems to me a matter for negotiation between the lenders and the borrowers, but I think I can assure you that so far as I know about it—and I don't know all the details—you would not find the rate on this loan out of keeping with rates on other loans to similarly situated borrowers.

Mr. **Levitas**. Based on what you know now or what you have been informed, would you confirm that the loan is now being negotiated at an interest rate in excess of 20 percent?

Mr. **Volcker**. Let me say from what I know of it that I am fully confident that this is an arm's length negotiation with respect to the interest rate.

Mr. **Levitas**. Somehow I think that is not responsive to my question.

I just want to know is it above 20 percent?

Mr. **Volcker**. That would, in part, depend upon what the prime rate is at the time; I don't suggest the loan is at precisely the prime rate either.

Mr. **Levitas**. From information that I have been provided, I understand that the interest rate is being negotiated between 20 and 25 percent. Does that sound like I got wrong information?

Mr. **Volcker**. Not necessarily, no.

Mr. **Levitas**. You stated, and I think this is extremely important, that steps will be taken to assure that the restructured loan cannot be used for further speculation. Would you explain what type of steps, contractual arrangements, written provisions, verbal assurances, just what type?

Mr. **Volcker**. As I indicated in my statement, I thought it would be useful, to avoid any possible confusion, that perhaps they ought to put in writing perhaps precisely what provisions they intended in this respect, and they agreed to do so.

Mr. **Levitas**. To whom did you make this suggestion?

Mr. **Volcker**. To the banks.

Mr. **Levitas**. When did you make that suggestion?

Mr. **Volcker**. The specific suggestion to put it in writing? I don't precisely recall. It was before a meeting that we had a week ago Friday to discuss this particular point. I had made it perfectly clear orally earlier than that, right from the start.

Mr. **Levitas**. Was this one of the suggestions you made in your discussions at Boca Raton?

Mr. **Volcker**. That was a different credit. I had indicated in general terms to the Engelhard interests when they first told me of their problems and mentioned what was then an extremely vague idea of somehow restructuring the credit, that my concern would be that it not contribute to any speculation, but that was a very general conversation.

Mr. **Levitas**. How will this be forwarded?

Mr. **Volcker**. I think at this stage it will be forwarded by covenants in the provisions of the loan agreement.

Mr. **Levitas**. I have also received information that shortly after the crash came in the silver market almost immediately the Hunts went back into the market, particularly in Europe, to purchase silver. Does this square with information you have received?

Mr. **Volcker**. I have no knowledge of that.

Mr. **Rosenthal**. Would you yield for one question?

Mr. **Levitas**. I would be happy to yield.

Mr. **Rosenthal**. Could it be described that you are shepherding this loan along?

Mr. **Volcker**. No.

Mr. **Rosenthal**. You seem to be helping it move along. You spoke to the banks.

Mr. **Volcker**. If you interpret "helping it move along" as making as clear as I could possibly make it that any loan of this sort had to contain safeguards against renewed speculation, that is not exactly my definition of "shepherding." Maybe it is yours.

Mr. **Rosenthal**. If the Hunts don't get this loan, what will happen?

Mr. **Volcker**. If the Hunts don't get this loan, I think the creditors will feel that they are in a somewhat less secure and stable position than they would otherwise be in, and that this could have some repercussions for the market generally and, from my point of view, we will be less protected on the speculative side than otherwise.

Mr. **Rosenthal**. Do you think that the banks are acting more favorably towards the Hunts because of your presence or involvement, your interest, your concern?

Mr. **Volcker**. Quite to the contrary.

Mr. **Rosenthal**. Thank you.

Mr. **Levitas**. Thank you, Mr. Chairman.

Mr. **Volcker**. But in saying that I think the banks, themselves, were sensitive to this speculative point. They were aware of the loan restraint program. I think they are aware of the public policy issue involved, but I certainly don't make life any easier for them.

Mr. **Rosenthal**. But does any other private individual in this country have your interest to the extent that the Hunts do?

Mr. **Volcker**. The Hunts have my interest? I am not sure that that would be a general interpretation.

Mr. **Rosenthal**. Do you want them to get the loan?

Mr. **Volcker**. I have no objection to the loan, provided that these conditions are met. I think the loan is not inconsistent with the public interest.

Mr. **Rosenthal**. Do you want them to get the loan?

Mr. **Volcker**. Do I want them to get the loan? I don't want them to get the loan on any terms other than what I suggested with respect to the speculation.

Look, you are suggesting something. It is not my function to "want" or "unwant" in some sense. I don't want or unwant any borrower to get a loan or not get a loan. If we have loan restraint, after going through this experience, I certainly do not want the Hunts to resume speculation in silver or other commodity markets.

Mr. **Rosenthal**. If they don't get this loan, they are not resuming speculation, you can bet on that.

Mr. **Volcker**. I don't know. They are not tied down. If the price of silver goes up, they will be in a good cash position.

They can do what they want to do as things now stand.

Mr. **Rosenthal**. Mr. Levitas.

Mr. **Levitas**. Thank you, Mr. Chairman. You really anticipated some questions I was going to get into and I think I might as well, before I turn to those, complete my questions about how you suggested specifically to the banks the covenants or written commitments to prevent silver speculation.

What do you suggest that these covenants provide?

Mr. **Volcker**. You say, "I suggested." Just in the interest of being as accurate as I can, as I already indicated, they were also sensitive to these points when they raised the issue with me, so it wasn't a matter in every case that I had to suggest covenants because they had already thought of them themselves.

Mr. **Levitas**. You made it, I think, abundantly clear that you are very concerned that this not be used for further speculation.

Mr. **Volcker**. Right.

Mr. **Levitas**. And at the outset that you had made this point known verbally and then again in writing.

Mr. **Volcker**. There are a number of parties involved in this whole transaction, Placid Oil, the Hunt family, and the banks themselves.

Some of the basic elements of a covenant should be no new purchases of silver, no new commodity positions, no new speculative positions in any area of financial or commodity markets, and orderly liquidation consistent with business judgment of the existing positions.

Mr. **Levitas**. Have you had an opportunity to see or have you asked to see any of these covenants?

Mr. **Volcker**. Let me just add one other point, that there would also be independent professional advice to follow the situation during the life of the loan.

I have not seen the covenants in any final, legal form. I have seen some language in more general terms that covers these points.

Mr. **Levitas**. I am not sure I understand that.

Mr. **Volcker**. I haven't seen a loan agreement. I have seen memorandums or letters that set forth these understandings.

Mr. **Levitas**. Have you asked to see the final versions? It is a very important matter to you. It is a very important matter to the financial community, to the economy. Have you asked to see the final wording?

Mr. **Volcker.** I don't remember making a specific request to see the final wording, but I would presume that we would see that in due course if this loan is completed.

Mr. **Levitas.** Do you intend to ask to see them?

Mr. **Volcker.** As I said, I expect to see them, yes——

Mr. **Levitas.** Now, you say that these——

Mr. **Volcker.** I or my staff anyway.

Mr. **Levitas.** You say that the general tenor of these covenants is that the funds are not to be used for speculative purposes.

Mr. **Volcker.** That is defined quite strictly in no new purchase——

Mr. **Levitas.** No new purchase of what? What about purchasing of Louisiana land?

Mr. **Volcker.** No new purchases of commodities, silver, other forms of potentially speculative financial investments.

Mr. **Levitas.** There was a——

Mr. **Volcker.** This specifically does not include normal business operations.

Mr. **Levitas.** There was a report in Business Week that half of the hundred million dollars invested by Placid in Louisiana land exploration was borrowed from Merrill Lynch. Would you consider that a borrowing for speculative purposes?

Mr. **Volcker.** I am not familiar with that situation. I don't think I can comment on it.

Mr. **Levitas.** One thing that I am curious about is who was involved in changing the rules on the margin, reserve requirements of the commodity exchanges?

Mr. **Volcker.** The commodity exchanges.

Mr. **Levitas.** The boards of governors of those exchanges?

Mr. **Volcker.** Yes.

Mr. **Levitas.** Do you know, or have you heard whether any of those governors themselves had positions in silver, silver contracts?

Mr. **Volcker.** I know nothing about that.

Mr. **Levitas.** You have no information whatsoever about that? Usually when somebody is losing money as the Hunts did in the crash of the silver market, somebody is making money. Everybody is not losing.

Do you have any information as to who has been making money while the Hunts have been losing it?

Mr. **Volcker.** No: and that would be hard to identify. People are making money, but on what may have been hedges. In a sense, they make money by avoiding a loss, in part. Somebody that has a big silver position in the normal course of his business is saved from a loss that otherwise would have occurred when the market declined. That is one definition of making money.

Mr. **St Germain.** Will the gentleman yield?

Mr. **Levitas.** Be happy to yield.

Mr. **St Germain.** Something just occurred to me, Chairman Volcker.

In the past ordinarily I would expect to see Governor Partee sitting in that seat today because essentially it is more or less a regulatory situation, and I am impressed with the importance of this overall situation since indeed, since let's say since Boca Raton—that is a glamorous name—you have been very, very intimately involved yourself.

Isn't it unusual that you become this involved in a loan arrangement? Isn't it usually Governor Partee who would be exercising most of the control and jurisdiction on a day to day basis?

Mr. **Volcker**. This whole situation, of course, involves more than this particular loan arrangement. This is quite an important matter, Mr. St Germain, in terms of its repercussions on economic policy and the financial system generally. I am referring to the whole episode, in which I naturally became involved at an early stage.

Mr. **Rosenthal**. The time of the gentleman has expired. Mr. Deckard.

Mr. **Deckard**. Thank you, Mr. Chairman.

Governor, I know you have expressed concern that credit should not be used for further speculation in this matter. I am concerned as a matter of fact that some of the loans that have been under discussion this morning might at least indirectly lead to further speculation by the Hunts. I would like to make reference to the bottom of page 4 and the top of page 5 of your prepared testimony which reads:

> The alternative, as the company saw it, was to negotiate with the help of some banks a credit to the Hunts or intermediaries that could provide time for repayment and avoid forced liquidation of silver in an already nervous, depressed market.

But the market at that point, somewhere in the area of $10 I believe, was depressed to what might be considered a more normal level, recognizing that it was perhaps in the area of $5 or $6 several years earlier, but these loans permitted the Hunts to retain their vast silver holdings, thus helping them to maintain what was an already formidable position in the market, and thus in a position somewhat near the point where the market could indeed be cornered.

Would you agree that that would be one of the effects?

Mr. **Volcker**. Of course that particular arrangement at that point referred to in my testimony was never consummated, but there was a situation then where the creditors, in this case Engelhard, were naturally interested in protecting their own position. They were facing a very, very large loss.

The natural reaction of a creditor facing a very large loss is to try to make an arrangement with the debtor to come to a mutually agreeable accommodation, which is what they did, bilaterally.

As I pointed out in my statement, one of the byproducts of these kinds of arrangements is, indeed, to relieve pressure on the immediate financial position of the Hunts. I think that is an inevitable byproduct and, I think, in the interest of the Hunts, or they wouldn't be willing to engage in the negotiation at all, but more immediately in the interests of the creditors who were protecting their own position.

Now, that is one of the reasons why I have been particularly concerned, and all of us involved, I think, have been concerned about making sure that this did not give rise to any renewed speculation.

Mr. Deckard. Let me approach it from a slightly different direction. Before I do, let me ask you this: To the best of your knowledge, do the Hunts' silver holdings for the most part equal the holdings they had prior to this precipitous drop?

Mr. Volcker. To the best of my knowledge, they are significantly reduced, but still very large.

Mr. Deckard. I know you are not responsible for what appears in the newspapers so I do want to ask you if this report contained in the Washington Post on Thursday, April 24, is true. They had the headline "The Fed is allowing major banks to lend Hunts $800 million."

One paragraph states: "Both Volcker and Heimann agreed that they approved the loan which was secured by the Hunt Oil holdings."

Mr. Volcker. I neither approved nor disapproved of the loan. I think, again, the issue that was presented to us was private lenders at their own initiative, entirely at their initiative—I didn't suggest it to them—conceived the idea——

Mr. Deckard. Would you or the Board have been in a position to stop the loan?

Mr. Volcker. I doubt it. I don't see that we have any grounds of stopping the loan except in the speculative aspect.

We haven't got any business telling a creditor he can't rearrange his loans with a debtor. The handle that we had, in a sense, was this loan restraint program, which is a special program involving speculative activity. I conceived our particular responsibility to be to make sure that this loan did not contribute to any speculative activity, but I think you are quite right that we haven't got any legal or even moral authority to tell the creditor he can't restructure a loan to a debtor.

It so happens, let me say again, as I indicated in the statement, that to the extent that this indeed strengthens the position of the creditor—and the Hunts are still in residual risk position—to the extent it contributes to stability in the financial system, that is not contrary to the public interest either.

Mr. Deckard. You do have the authority to stop that loan if you regarded the loan as being rooted in speculation?

Mr. Volcker. As I indicated earlier, that is a voluntary program, but I think, to quote somebody from a newspaper, I have sufficient "moral authority" to have stopped it if I thought it violated the speculative precepts. In fact, that is the question the banks asked me.

Mr. Deckard. This is the point I am trying to get at. I know you are unlikely to know the full extent of the Hunt holdings exclusive of the silver, I make reference to another portion of the newspaper article that I referred to earlier, "That would have forced the Hunts to turn over their silver which might have flooded the market with the metal forcing prices even lower and making the problem worse" the Federal regulator said. Does it appear likely that the Hunts would have been forced to begin massive sales of their silver holdings to meet their obligations had not these loans been approved?

Mr. Volcker. You say "approved" again. I did not approve or disapprove. This loan arrangement has not been completed, some temporary arrangements have been made.

As I said, the weaker creditors are out of the market and the market has not, recently anyway, performed in a sense that raised that specter immediately, but I think that risk does lie in the background.

Mr. Deckard. It just seems to me that it is likely that with the continued holdings of the Hunts, which do remain at a massive level, that the price of silver, even though it may be at a lower price because of the increased margin requirements, will still be driven inexorably upward, in effect rescuing the Hunts from their speculative position.

Mr. Volcker. As I have pointed out in the statement, it is inherent in this situation, due to the speculation that already took place, that there is a large mass of silver in control of a single hand. That is ameliorated, in what is an unfortunate situation, by provisions in the potential loan agreement that censure the purpose of the loan agreement is not to permit further speculation and that look toward liquidation of this particular position over a period of time.

Mr. Deckard. There are allegations that the Placid Oil Co., or the Hunts, will use new loans to invest in or take over a corporation, especially Gulf Resources, which operates a silver refinery.

Would that be a violation of Federal guidelines against speculative use of credit?

Mr. Volcker. This matter has not come to my attention at all. That is certainly not what is contemplated in this loan agreement. Placid Oil Co. is competent to borrow money in any way it sees fit. We have another guideline which is designed to discourage takeovers.

Mr. Deckard. My point is, we have to look at some of the other activities of the Hunt brothers in the past. We want to be certain no indirect help is being provided by the Government and financiers to perpetuate what appears from the outside looking in as an attempt to corner the silver market.

The purchase of 2 million shares of Gulf Resources, which is a major silver mining company, appears to fit into that mold. The Hunt brothers still hold massive amounts of silver. Those massive holdings were what precipitated the rise in silver prices in the beginning. They still retain those holdings.

My point is that we still have the same set of circumstances existing today that led to the increase in prices in the first place. I think they are still speculating, I think they are being assisted in that.

Mr. Volcker. I cannot do anything about the situation that arose over earlier months that gave rise to that accumulation of silver; that is history. What I will say is that, assuming this credit goes through, the public interest is far better protected against any renewal of that speculative activity, and it will enhance the prospects for that lump of silver being dispersed.

That is the nature of this loan understanding. I don't think there is any question of that. In that sense, the public interest is protected. But if you ask me a different question, whether the whole situation is unfortunate, of course it is.

Mr. **Deckard**. If the Hunts own too much silver now, wouldn't it be healthier if the Hunts were not bailed out by bank loans but had to liquidate their current silver holdings?

Mr. **Volcker**. First of all, it is not in the immediate interest of the creditors who are directly involved here. This is their initiative.

Mr. **Deckard**. They would be willing to deal in silver, wouldn't they?

Mr. **Volcker**. The creditors don't want a bunch of bad loans on their hands. That is why they are looking for different security.

Mr. **Deckard**. Is it in the interest of consumers?

Mr. **Volcker**. It is not in the interest of consumers, it is not in the interest of financial markets, it is not in the interest of farmers or homebuilders to have enormous stresses and strains on the financial markets resulting from this situation.

Mr. **Deckard**. Including silver prices of $50 an ounce?

Mr. **Volcker**. That is history. It arose without the use of credit. It is unfortunate.

Mr. **Deckard**. It arose through the actions of the Hunt brothers.

Mr. **Volcker**. No question of that, but that is a situation that I have inherited at this point. There is nothing I can do about it now. I was left with the residual problem that the Hunt brothers owned a lot of silver.

They may not own it, or own it all, after this transaction because the ownership may be transferred. The ownership will come into different hands subject to all the restrictions of this loan agreement, including the prospect of orderly liquidation.

Mr. **Deckard**. My point is that the Hunts are now in a position to do what they have done before and they are in that position simply because of the bailout that is involved.

Mr. **Volcker**. Now or after this loan agreement?

Mr. **Deckard**. By private financiers with the tacit approval of the Fed.

Mr. **Volcker**. I doubt if they are in that position right at the moment. I don't know that they have the credit and the ability to engage in fresh speculation at this point. After the agreement they will certainly not be in that position because they will be prohibited by the terms of the agreement to do it.

Mr. **Rosenthal**. Would you yield for a question?

Mr. **Deckard**. Yes.

Mr. **Rosenthal**. How will you know how they are using that money? Let's assume it is in the agreement and they say to heck with the agreement, I will do what I want with the money.

Mr. **Volcker**. The use of the money will be controlled by the lending institution.

Mr. **Rosenthal**. The banks are going to follow the money? How are they going to follow this?

Mr. **Volcker**. I am assured that, to the extent of human ingenuity, the banks have an interest in following it.

Mr. **Rosenthal**. You are not measuring the Hunt's ingenuity against this consortium of banks, are you?

Mr. **Volcker**. I don't know what to do about the Hunt's ingenuity.

Mr. Rosenthal. It sounds naive to me to think you can enforce it.

Mr. Volcker. To the extent humanly possibly that is the nature of this loan agreement. I am not running a police force to follow the Hunts around.

Mr. Rosenthal. But the banks are cooperating because they sense you would like them to cooperate. They know you consider this important to the integrity of the financial markets. They are not only protecting their own interests, they are cooperating for what they think is in their interest.

To give the Hunts $1 billion with contractual restrictions and no other inhibitions of any kind whatsoever——

Mr. Volcker. Those are pretty big inhibitions.

Mr. Rosenthal. Not for guys willing to take on Congress.

Mr. Volcker. Your earlier suggestion was that I don't care what happens, that I am sitting at the Federal Reserve and wash my hands of this situation while the brokerage houses go broke and the banks get involved, saying, "Well, so be it, that is not my business."

Are you suggesting that is the attitude I take?

Mr. Rosenthal. The point Mr. Deckard is making, with which I tend to agree, is that so long as the Hunts hold the silver and you give them the $1 billion, they can go through the same scenario all over again.

Mr. Volcker. My whole effort has been directed precisely toward preventing that scenario.

Mr. Rosenthal. We congratulate you for that, but it seems to me that there are not going to be in fact legitimate legal and/or physical constraints on what they do with the $1 billion.

Mr. Volcker. There will be to the best of my knowledge both legal and physical restraints. By physical restraints I don't mean we have the Hunts tied and handcuffed. I mean to the best of their ability the banks will control their use of these funds.

Mr. Rosenthal. Have you had any consultations with the Congress for this bailout procedure?

Mr. Volcker. No, sir.

Mr. Rosenthal. What is the difference between this and loans to Chrysler or this and New York?

Mr. Volcker. There is no public money involved in this.

Mr. Rosenthal. There is Federal Deposit Insurance Corporation money riding on that loan.

Mr. Volcker. I don't think banks are in that position.

Mr. Deckard. Well, it seems obvious that had not these loans been approved to the Hunts——

Mr. Volcker. The loans have not been approved or made.

Mr. Deckard. The loans were not disapproved.

Mr. Volcker. That is correct.

Mr. Deckard. The Hunts would have been forced to liquidate their silver holdings.

Mr. Volcker. The loans have not been made and the Hunts have liquidated some of their silver holdings, to my knowledge. With, or without this loan, they will retain some.

Mr. **Deckard.** Do you think it is a healthy situation for this amount of holdings to be concentrated in the hands of one or two people?

Mr. **Volcker.** No; as I said in my statement, it is not a healthy situation.

Mr. **Deckard.** But the action of the Fed in failing to disapprove the loans have kept this amount of holdings in the hands of one or two people, thereby setting up circumstances that could lead to the same type of pyramiding that created the situation in the first place.

Mr. **Volcker.** Quite the contrary, Mr. Deckard. If, in your language, we disapprove of this loan, the Hunts still own the silver. The Hunts own the silver unencumbered.

Mr. **Deckard.** But they have obligations——

Mr. **Volcker.** They not only have obligations before the loan, but they have covenants in the loan that prevent them from doing what you are talking about. In fact, they wouldn't hold most of the silver after the loan.

Mr. **Deckard.** The pattern of the Hunt's activities, given some of their past activities in other commodities markets, has all the earmarks of someone trying to corner the market.

Mr. **Volcker.** That is precisely why I am concerned about the situation.

Mr. **Deckard.** But not so concerned about the possible speculative intent of the Hunt brothers to disapprove the loan?

Mr. **Volcker.** To the contrary.

Mr. **Deckard.** You do have the authority to disapprove the loan?

Mr. **Volcker.** The result of the loan seems to be, unambiguously, to reduce the concern that you have. For the life of the loan, my own judgment is that we will reduce that concern to the vanishing point. I don't know how long the loan will be outstanding.

Mr. **Deckard.** From my point of view it does precisely the opposite. It helps perpetuate the Hunt holdings in silver.

Mr. **Volcker.** That is a different judgment.

Mr. **Deckard.** Thank you, Mr. Chairman.

Mr. **Rosenthal.** Mr. Atkinson?

Mr. **Atkinson.** The Federal Reserve monitors the total consumer credit, correct?

Mr. **Volcker.** Yes, sir.

Mr. **Atkinson.** What figure was that last year? Would you know that by chance?

Mr. **Volcker.** Total consumer credit was something like $375 billion. That is not including mortgage loans.

Mr. **Atkinson.** I understand. Responsive to the chairman's question you stated the effect of this loan on the financial markets would be indirectly stabilized. That is your statement earlier.

Mr. **Volcker.** Yes.

Mr. **Atkinson.** Can you expand on that reasoning and explain to this subcommittee how the Federal Reserve can claim such a loan has a stabilizing effect and yet restrict consumer credit use under the President's credit program, as he announced it last March? I understand about the 5 percent lessening, because of the President's effort, and I am wondering, does this fly in the face of that and what impact will it have?

Mr. **Volcker**. Let me make a distinction between this loan and the whole situation. The whole situation has not been stabilizing. We inherited a situation where we already had the speculation in the silver market and already had extensions of credit outstanding. This is only a restructuring of what was outstanding.

If you asked me whether this whole incident is helpful, it is not, but I was addressing myself to the particular restructuring here, to the whole speculative incident.

The fact that as the market turned a lot of credit was involved, along with disturbances to the commodity market and the threat to some financial institutions, all of that was not helpful except as a lesson for the future.

But, when you just look at it at this stage—picking up the pieces, so to speak—then you have a different picture with respect to this loan.

Mr. **Rosenthal**. Mr. St Germain?

Mr. **St Germain**. You just said threat to financial institutions?

Mr. **Volcker**. I am using the word financial institutions to mean not just banks, but the brokerage and commodity institutions involved.

Mr. **St Germain**. So there were not any banks threatened?

Mr. **Volcker**. To the best of my knowledge, there were no banks facing a threat to their own stability. They may have felt uncomfortable about potential losses, but that is a different matter.

Mr. **Atkinson**. Doesn't the restructuring raise the interest rates on these existing credits?

Mr. **Volcker**. No, I don't see why.

Mr. **Atkinson**. There is no comparison with this loan to the Hunts in comparison with the President's effort on credit control?

Mr. **Volcker**. Provided that the speculative concerns are adequately taken care of—as I just discussed with Mr. Deckard, apparently with a difference of opinion—my conclusion is that this will provide added protection against a renewal of this episode.

I am quite clear about that. At this stage it is a restructuring and doesn't take net additions of credit. I am not arguing that the whole incident is helpful; it is unfortunate.

Mr. **Rosenthal**. Mr. St Germain.

Mr. **St Germain**. Mr. Chairman, you mentioned the restrictive covenants that you have not as yet seen but will be seeing?

Mr. **Volcker**. I have not seen them in a final, legal form.

Mr. **St Germain**. Would it be possible—assuming they will be—once the restrictive covenants are written they will be pretty much boiler plate for most of these loans with the participating banks? Would that be a fair assumption?

Mr. **Volcker**. My understanding is that this will be done by a joint committee. I presume it will be one agreement.

Mr. **St Germain**. I don't see that a restrictive covenant, particularly since you have enunciated it in these hearings, will come under the privacy veil. That being the case, would you be able to provide the committee with a copy of the restrictive covenant once it has been agreed upon?

Mr. **Volcker**. I would like to talk to the bankers about that. I have already talked about it in general terms here, and I would like to talk with them and see whether they have any objection.

Mr. **St Germain**. Who are they to have an objection? I am asking you, under the law, I don't see any problem with it. Who are they to have an objection?

Mr. **Volcker**. I don't know what the legal situation is, but I just feel a little uncomfortable about saying that I have a particular authority to show you a private loan agreement.

Mr. **St Germain**. We are asking for one section, the restrictive covenant.

Mr. **Volcker**. I understand. I would hope that we could do that.

Mr. **St Germain**. You said earlier that you sent an advisory to the Federal Reserve banks that the banks participating in this $800-million loss of silver restructuring would not be given any special treatment at the discount window.

When we asked you if they would be, you said you told the regional banks that they were not to give special consideration.

Mr. **Volcker**. I didn't mean to suggest I sent any formal advisory to them, because the issue has not arisen, the banks have not raised that question. I can assure you no preference would have been involved at the discount window.

I fully agree with the sense of what you were saying. I wanted to convey the idea that there would be no special preference. There is no reason for any regional bank to give any special preference. There is no special preference that will be given. I just didn't want you to be misled that I sent out some special notice. I didn't conceive of the need to do that.

Mr. **St Germain**. Mr. Heimann, when did you say that your examiners spotted the activities or the concentration here of loans to the Hunts?

Mr. **Heimann**. The examiners in one or two institutions have been aware of Hunt-related activities in that institution. That has gone back some period of time. I don't know precisely, but for the last couple of years.

Mr. **St Germain**. And these activities in that bank, in other words, would these have dealt with borrowings that were then used for the purchase of silver?

Mr. **Heimann**. To my recollection most of the activity of those loans had nothing to do with silver. They were normal business operations of the various Hunt interests. As you know, there are quite a few corporations involved.

Mr. **St Germain**. Again, talking to both of you, as far as the loans to the Hunts are concerned, as you state, they borrowed from a great many financial institutions. I have never thought of brokerage houses as financial institutions. I am having a problem with that.

Mr. **Volcker**. I am glad you raised the question. I did not want to raise the specter in your mind or anybody else's mind.

Mr. **St Germain**. Do we know if any of the banks lending to the Hunts exceeded the statutory 10 percent of capital assets as far as loans to the Hunts were concerned?

Mr. **Heimann**. To our knowledge in both the national banks and the State member banks, no bank exceeded the limits that apply to the system.

Mr. **St Germain**. Now I would like to pick up on what Mr. Deckard was discussing with you, Chairman Volcker, and just state this: The covenant against further speculation in silver is what will be contained——

Mr. **Volcker**. Not just in silver.

Mr. **St Germain**. Not just in silver. Any speculative activities whatsoever?

Mr. **Volcker**. In commodity markets.

Mr. **St Germain**. They have been in soybeans.

Mr. **Volcker**. I don't know about soybeans, but they have been in a lot of things.

Mr. **St Germain**. I think it is rather important that we insure that they didn't use this restructuring of credit to a substantial degree, to the tune of $800 million or more, to stabilize their condition at the present time, and then proceed on their merry way and just keep up the good work as far as they are concerned and hurt the consumer.

Mr. **Volcker**. That is our whole purpose.

Mr. **St Germain**. Now, you know as a result of their pyramiding, the price of silver went up to $50. We have people in the audience here that I met with yesterday morning, along with the members of the staff people from the various States, where jewelry is produced and manufactured.

They are concerned about the fact that the price of gold is so unstable, as has been the price of silver, that retailers don't want to buy because they look at the graphs, the charts.

Now, particularly in the case of silver, they don't know, they don't have a real plan yet to see what relief they can look for. They went to Treasury yesterday for relief as far as the price of gold is concerned.

This fluctuation was all due to the individuals who are speculating in silver. You answered that in the affirmative earlier to one of the earlier questions. That was the fact that the rise in the price of silver was due to the massive speculation by the Hunt brothers.

Mr. **Volcker**. Let me make a general point here, if I can. There is no question that the performance of the silver market was reflecting their activities, and the performance of the silver market in turn affects other markets.

But I think it is very important to remember that this kind of instability and this kind of speculation breeds and finds fertile ground in an atmosphere of general uncertainty and, particularly, in an atmosphere of inflation.

The gold market has been gyrating up and down for some time, as you know. I think this is a reflection, in the broadest sense, of a sense of uncertainty, particularly uncertainty about inflation. It is symptomatic of the kind of problems that arise when there is a lack of confidence in the basic stability of the currency.

I just want to make that general point because, as we look at these particular incidents and the consequences of this particular speculative incident, we need to put it in a somewhat broader context and ask why were there conditions that made this feasible in the first place.

I think we have to look to the general economic conditions as part of that explanation.

Mr. **St Germain**. Yes, Mr. Chairman, but the fact still remains that the price shot to $50 an ounce as a result of this massive speculation by the Hunt brothers.

Mr. **Volcker**. But there was other speculation in other commodity markets at the same time, and they were feeding on each other.

Mr. **St Germain**. But they took advantage of that.

Mr. **Volcker**. No question.

Mr. **St Germain**. As a result thereof thousands of people were put out of work. We had that evidence yesterday, in the State of New York, State of Rhode Island, Connecticut, New Jersey, California. Thousands of people were put out of work. It hurt a lot of people.

Mr. **Volcker**. Yes.

Mr. **St Germain**. Here we are, we are looking the other way at that $800 million loan. I wonder as to the equity of it all.

Mr. **Volcker**. I don't think we are looking the other way. We are trying as best we can, where we have inherited the situation that you described, to look forward to the most stabilizing kind of action with the maximum protection against a renewal of this episode. That is the concern, the maximum protection against a renewal of the episode. I can't repair the damage that was done before.

Mr. **St Germain**. I think you remember our revered Chairman Wright Patman when he was yelling about loans to the gambling casinos when businessmen couldn't get loans. This is reminiscent of the same thing. This was gambling.

Mr. **Volcker**. This was gambling, there is no question about that. But, again, the difficulty and the reason why this takes some studying is because of the performance of the market itself, its characteristic of not requiring any credit on the up side. It took credit when things began falling apart, but the speculation that threw those people out of work was done by pyramiding profits.

Mr. **St Germain**. Last, Mr. Heimann, I asked you a question about exceeding the 10 percent of assets as to loans to the Hunts as individuals. How about Hunt-controlled corporate loans? Did you find any loans that were in excess of the 10-percent statutory limit by any financial institutions; to wit, banks?

Mr. **Heimann**. To date, no.

Mr. **St Germain**. Thank you, Mr. Chairman.

Mr. **Rosenthal**. Mr. Levitas?

Mr. **Levitas**. Mr. Volcker, if the Hunts were to sell their silver which they now own, do you have any sense that that would provide sufficient funds to honor their present commitments without this loan restructuring?

Mr. **Volcker**. It depends upon the price of silver, of course.

Mr. **Levitas**. It is about $14.

Mr. **Volcker**. I think it would, at the present price of silver. To the best of my knowledge, the loans are margined, in effect.

Mr. **Levitas**. At the present price. According to your information that a liquidation by the Hunts would not be adequate to meet their present commitments——

Mr. **Volcker**. I think it would be, at the present price. But I don't know all the details. That is an impression I have.

Mr. **Levitas**. That is the impression I have, too. If that is the case, the U.S. banks are involved—and I emphasize U.S. banks—

and the U.S. brokerage houses that are involved would not be at risk.

Mr. **Volcker**. There are risks depending upon the silver price.

Mr. **Levitas**. But if the silver prices were not substantially adversely affected by that liquidation, then the point that I am making is that the $800 million or $1 billion loan, which according to information I have represents about 1 percent of all commercial and industrial loans as of January 1980, would not be necessary.

I think the point Mr. St Germain has been making that disturbs all of us, I think the public, that here are farmers and small businessmen and people who want to buy houses. They can't get money. Here is $800 million that is going to be restructured for them.

Mr. **Volcker**. The loans are already outstanding in another form. That has already been done. They can be liquidated as the silver is liquidated, and that is what will happen under the new loan agreement.

Mr. **Levitas**. Mr. St Germain calls to my attention that recently the administration, the President made available $135 million for housing which many people think is inadequate. Here we are talking about $800 million being made available solely for the Hunts.

What I am suggesting to you, Mr. Volcker, is that the American public views this whole transaction and the consequences of it in a very sensitive way, as Mr. Deckard said, if there are ways to liquidate this indebtedness and protect the U.S. banks and brokers without going through this restructuring, my sense is that at least the public would feel a lot better about it.

The sense is further that while you were not putting together the loan, that certainly there seems to be sort of, as you say in your testimony, an aura of that is what you would like to see done, that permeates this transaction.

Mr. **Volcker**. What I would like to see is protection against the speculative rebirth, and I would like to see liquidation of the silver. I think your chances of maximizing both of those results are probably improved.

Mr. **Rosenthal**. I assume we will adjourn before this next vote. Mr. Deckard?

Mr. **Deckard**. I have one question, and it is somewhat of a followup on what we were talking about earlier.

The Hunts, in order to meet their obligations, basically had two options. One was to sell their silver. The other was to put up other assets.

Given the fact that they chose to put up other assets, couldn't we infer from that that they have greater confidence in silver, confidence in the value of silver to increase over the next several months and years? isn't that a logical inference?

Mr. **Volcker**. I would think the most logical inference would be that if they are willing to accept all these restrictions and put up other assets—locking themselves out of the market in the future—that they are not all that confident. If they were confident, they would just sit pat.

Mr. **Deckard**. But there are no restrictions on further increases in the value of silver. The Fed doesn't have control over that.

Mr. **Volcker**. No; The Fed doesn't control that.

Mr. **Deckard**. They expect silver to increase. They expect the value of silver to increase. The point I am making is that the elements are still there that led to the precipitous increase in the first place.

Mr. **Volcker**. I don't think that is fully true, but I cannot cure fully what has been inherited. If they were sitting there confident that the price of silver was going to go up and wanted to engage in speculation, they certainly would not enter into these covenants. They would hold the silver, wait for the price to go up, buy some more and reengage in speculation. It seems to me apparent that leaving the Hunts free to engage in renewed speculation, would not be in the public interest of preventing a recurrence of this situation.

Mr. **Levitas**. Would the gentleman yield?

Mr. **Deckard**. Certainly.

Mr. **Levitas**. I don't follow that logic, Mr. Chairman, because if they are holding their silver and they can't use these new loans or this restructured loan for future speculation, the very holding of that silver for a sale subsequently when the market goes up is itself a speculation.

Mr. **Volcker**. That is the difficulty of any single group of people holding a big lump of a commodity. It is not a wholly satisfactory situation to say the least, but that is the situation we inherited.

Now, you are faced with a much more limited question. Is it against the public interest to tie that loan down against any future speculation to encourage the higher price of silver and at the same time be able to look forward, as part of these arrangements, to an orderly liquidation, or is it not? I think the balance of considerations there is pretty clear.

Mr. **Rosenthal**. I think the point being made by members of the subcommittee is that if they were not getting the loans with what appears to be your cooperation, they would have to liquidate the silver.

Mr. **Volcker**. That doesn't necessarily follow. Presumably, they can hold onto it. They can take their chances. Then you have the risk of the silver going way down and creating further market and financial disturbance, or you have the risk of the price going up and giving them all the leverage they need to engage in more speculation.

Mr. **Rosenthal**. The perception the public has is that the Chairman of the Federal Reserve took an interest that he thought was in the public interest to help and speak with the banks about the Hunts getting this loan.

You did in fact speak to banks?

Mr. **Volcker**. I undoubtedly spoke to the banks; they raised the issue with me. I feel a little bit caught in the middle here, Mr. Chairman, between some inference that we were not interested enough and that we are interested too much. You can accuse us of one or the other, but not both.

Mr. **Rosenthal**. You think the solution is for the Hunts to get more money?

Mr. **Volcker**. There is no more money involved here. This is a restructuring.

Mr. **Rosenthal**. I am not so sure about that. Mr. St Germain?

Mr. St Germain. Yes.

Mr. Chairman, if my memory is correct, the speculation being engaged in by the Hunts when it first came to your attention was in October, or you were aware in October?

Mr. Volcker. I was vaguely aware from rumors, gossip, newspapers.

Mr. St Germain. It was in the press. They blatantly said yes, they are buying up massive amounts of silver.

Mr. Volcker. We made inquiries and those stories were basically true.

Mr. St Germain. Obviously the Federal Reserve, because of your obligations and as far as the monetary system is concerned, and credit is concerned, for the purposes of the future, when something like this comes to your attention, do you think it might be wise for the Chairman of the Federal Reserve Board and the Board of Governors to say:

> Hunts, drop by and see us boys, let's have a discussion and see what you are doing and let's look at the future. We are going to tell you that we are looking with a jaundiced eye if you fail in this, so you better make sure that what you are doing succeeds.

This is Monday morning quarterbacking, but I think from this we should learn. What I am trying to get at here is just not let this go by the boards and allow them to restructure but let's look to the future when somebody is borrowing such massive amounts of money.

Mr. Volcker. Of course, they were not borrowing at that stage. But I agree with the general tenor of what you are saying, certainly applied to the Government as a whole.

It is quite clear we don't have any direct legal or other authority over the commodity market. Whether we should have been doing that or not, I don't know. But obviously the kind of point that you raise is relevant to what lessons we have learned from this whole experience.

Mr. St Germain. Lastly, because my chairman is getting nervous, it was reported that there were some Saudi Arabian sheiks involved in partnership in some of these transactions.

Has that come to your attention?

Mr. Volcker. Yes. There was apparently some kind of a partnership agreement between the Hunts and some foreign interests. I touched upon that earlier.

Mr. St Germain. Would it be nice if some of those sheiks lent the money to the Hunts and we would not have to?

Mr. Volcker. I think it was a joint activity.

Mr. Rosenthal. Thank you very much.

The committee is adjourned.

[Whereupon, at 12:40 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

SILVER PRICES AND THE ADEQUACY OF FEDERAL ACTIONS IN THE MARKETPLACE, 1979-80

FRIDAY, MAY 2, 1980

House of Representatives,
Commerce, Consumer,
and Monetary Affairs Subcommittee
of the Committee on Government Operations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2154, Rayburn House Office Building, Hon. Benjamin S. Rosenthal (chairman of the subcommittee) presiding.

Present: Representatives Benjamin S. Rosenthal, Eugene V. Atkinson, Fernand J. St Germain, John Conyers, Jr., Jim Jeffries, and Joel Deckard.

Also present: Representative Dan Glickman of Kansas.

Staff present: Peter S. Barash, staff director; Donald P. Tucker, chief economist; Barbara Timmer, counsel; Doris Faye Ballard, clerk; and Jack Shaw, minority professional staff, Committee on Government Operations.

Mr. Atkinson. It is necessary under the rules that this hearing be open to broadcasting. I so move.

Mr. Rosenthal. All indicate by saying aye. Any opposed?

The motion is carried.

Today, the Commerce, Consumer, and Monetary Affairs Subcommittee continues its investigation into the adequacy of the Federal response to recent events in the silver and related financial markets.

The Rules of the House of Representatives assign to the Government Operations Committee broad investigatory authority for the operation and activities of all Federal agencies and for the effectiveness of the laws they administer. The committee is authorized to conduct "investigations of any matter without regard to" the jurisdiction of other standing committees; and it is mandated to make its investigatory findings and recommendations available to those committees.

When the Government Operations Committee held its organizational meeting for the 96th Congress, this subcommittee was assigned specific oversight jurisdiction for the operations, activities, and effectiveness of laws administered by the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), the Federal banking agencies including the Federal Reserve, and the Department of the Treasury including the IRS.

The regulatory responsibilities of each of these agencies have been seriously impacted by events prior and subsequent to the recent collapse of the silver markets. When CFTC Chairman James

Stone testified before the subcommittee recently, he characterized this event as "a situation of financial panic which could affect not only the commodities markets but the stock market and possibly financial institutions as well." This subcommittee has oversight responsibility for each of the Federal agencies that supervise these far-flung but interrelated financial markets.

Four days of subcommittee hearings strongly suggest that the existing Federal regulatory apparatus is unable to prevent dangerous events in the commodities markets and the rippling effects of those events on the securities and banking industries and on other domestic and international financial markets. What this subcommittee must now determine is "why."

Our investigation requires the direct and detailed testimony, from Nelson Bunker and William Herbert Hunt, on the nature and extent of and reasons for their silver trading activities and the financing of those activities; on their relationships with other large traders and with commodity brokers, bankers, and securities dealers; on their use of foreign markets and exchanges; and on the regulatory and financial relief they have sought from Federal officials.

Only the testimony of these principals can provide the details necessary to our understanding of the operations of large commodity traders and the ability of existing laws and governmental structure to regulate their activities. The subcommittee seeks answers to the following questions:

What was the nature and extent of the Hunts' silver trading activities? Who did they join with and what was their purpose? What events triggered the collapse of the silver markets in late March of this year? Did the regulatory decisions of the Commodity Futures Trading Commission, the Federal Reserve, or the commodity exchanges influence market events?

Is the CFTC's surveillance of and response to speculative purchases of silver or other commodities by large brokers, like the Hunts, adequate?

What structural or jurisdictional changes are desirable among the Federal agencies that supervise the commodity and other financial markets?

How did the collapse of the silver markets affect and alter the Hunts' business dealings with securities and commodity dealers, bankers, and those persons associated with them in silver?

Did the Hunts' communications with Federal regulatory officials or with officials of commodities exchanges influence regulatory or supervisory decisions and events in the silver markets?

What is the nature and purpose of and what conditions govern the loan package presently being negotiated for the Hunts with the approval of the Federal Reserve?

What plans do the Hunts have relative to silver assets presently held and the further accumulation of silver assets?

The two witnesses I gather are here. Would both of you rise and would you take the following oath. Raise your right hand.

Do you solemnly swear that the testimony you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

STATEMENTS OF WILLIAM HERBERT HUNT AND NELSON BUNKER HUNT; ACCOMPANIED BY NORMAN J. BARRY, ATTORNEY, ROTHSCHILD, BARRY & MYERS, CHICAGO, ILL.; AND ROGER GOLDBURG, ATTORNEY, SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE, DALLAS, TEX.

Mr. W. H. **Hunt**. I do.

Mr. N. B. **Hunt**. I do.

Mr. **Rosenthal**. Would each of you identify yourself and give your address.

You may be seated.

Mr. N. B. **Hunt**. My name is Nelson Bunker Hunt, 2500 First National Bank Building, in Dallas.

Mr. **Rosenthal**. You are represented by counsel, Mr. Hunt?

Mr. N. B. **Hunt**. Yes, I am.

Mr. **Rosenthal**. Would your counsel identify himself.

Mr. **Barry**. Yes. Mr. Chairman, my name is Norman J. Barry. I am with the law firm of Rothschild, Barry & Myers, 2 First National Plaza, Chicago, Ill.

Mr. W. H. **Hunt**. My name is William Herbert Hunt, First National Bank Building in Dallas, Tex.

Mr. **Rosenthal**. Are you represented by counsel?

Mr. W. H. **Hunt**. Yes, I am.

Mr. **Rosenthal**. Would you identify the counsel.

Mr. **Goldburg**. Good morning, Mr. Chairman, my name is Roger Goldburg, I am a member of the firm of Shank, Irwin, Conant, Williamson & Grevelle, of Dallas, Tex.

Mr. **Rosenthal**. Do each of counsel have copies of the rules of the committee?

Mr. **Barry**. Yes, sir.

Mr. **Goldburg**. Yes.

Mr. **Rosenthal**. Now, a request has been made by counsel for one of the witnesses, or both, that flashbulb photographers desist from taking pictures during the course of their testimony. In view of the fact that most of the photographers that I can see do not in fact have flashbulbs, do you insist on that?

Mr. **Goldburg**. No.

Mr. W. H. **Hunt**. No, I have no objection.

Mr. N. B. **Hunt**. That is quite all right.

Mr. **Barry**. No, sir.

Mr. **Rosenthal**. Just so that the record is clear, at the last meeting of this subcommittee, it was voted to recommend that Messrs. Hunt be held in contempt of Congress for failure to appear on the return date of the subpena. Subsequent to that meeting we received a letter dated April 30, 1980, requesting an opportunity for the Hunts to appear before the subcommittee at an appropriate time.

Without objection, that letter will be included in the record. [The letter follows:]

SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE
ATTORNEYS AT LAW
3100 FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202
(214) 748-0000

TELECOPIER:
(214) 748-0880

April 30, 1980

HAND DELIVERED

The Honorable Jack Brooks
Chairman
Committee on Government Operations
U.S. House of Representatives
2157 Rayburn Office Building
Washington, D.C. 20515

The Honorable Benjamin S. Rosenthal
Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs
U.S. House of Representatives
B377 Rayburn Office Building
Washington, D.C. 20515

Dear Mr. Chairmen:

Pursuant to my conversation this morning with Staff Director of the Subcommittee on Commerce, Consumer, and Monetary Affairs, Peter S. Barish, Esquire, I wish to confirm for your consideration the following thoughts on behalf of our clients, Nelson Bunker Hunt and William Herbert Hunt, pertaining to the scheduling of their potential testimony before your Subcommittee:

(1) As you know, we timely filed an application to vacate and/or quash the subpoenas issued by the Subcommittee compelling the testimony of our clients before it, which application articulated our clients' position with respect to the subpoenas. Our application was filed directly with the Subcommittee (rather than pursuing alternative courses of action in other forums) to demonstrate our good faith in attempting to work with and through the Subcommittee to provide certain testimony it seeks and, at the same time, give heed to basic considerations of fairness to our clients. I further point out that our clients have not at any point in time refused to appear before the Subcommittee. Rather, they have asked that their testimony be coordinated with testimony to be supplied to other governmental bodies in a manner

that will meet the needs of your Subcommittee and those of other Congressional and Executive bodies seeking information, while at the same time recognizing and protecting the legitimate rights of our clients.

(2) In order to obviate the need for a lengthy, time-consuming proceeding in connection with the matters raised on the record made before the Subcommittee at yesterday's hearing, and to fix a date certain upon which our clients will respond to the subpoenas, I am at liberty to propose for your consideration that our clients appear before the Subcommittee on Friday morning, May 2, 1980.

(3) Our clients have also agreed voluntarily to appear before Senator Stewart's Subcommittee on Friday, May 2, 1980. In a spirit of cooperation between the Senate and House, Senator Stewart has agreed to schedule the time for our clients' appearance before the Senate Subcommittee for the afternoon session of that Subcommittee's hearings commencing at 2:00 p.m. Accordingly, our clients could then appear before your Subcommittee at its morning session in response to the subpoenas. We propose such an appearance. Moreover, should you wish, in your discretion, we would be agreeable to starting those morning proceedings at a time earlier than 10:00 a.m. so as to facilitate the progress of the Subcommittee's business.

(4) We respectfully insist, on behalf of our clients, that all further processes in connection with the Subcommittee's determination to seek contempt sanctions against our clients be terminated.

Our clients will appear and will provide testimony for your Subcommittee. It is our hope that arrangements can be consummated consistent with this proposal.

Respectfully submitted,

Roger Goldberg

Roger Goldburg

by RGS

cc: The Honorable Frank Horton
The Honorable Lyle Williams

RG:meg

Mr. ROSENTHAL. Thereafter, on May 1, 1980, and after consultation with the members of the subcommittee, the chairman sent the following letter dated May 1, 1980, to Roger Goldburg, Esq., and to Paul Perito:

> This is in response to Mr. Goldburg's letter of April 30, 1980, and the proposal contained therein. The members of the subcommittee agree that if your clients, Nelson Bunker Hunt and William Herbert Hunt, appear and testify before the subcommittee at 9:30 a.m., Friday, May 2, 1980, in room 2154, Rayburn House Office Building, and if in the judgment of the subcommittee your clients testify fully and completely, and otherwise cooperate with the subcommittee's investigation, the subcommittee will withdraw its contempt recommendation against Nelson Bunker Hunt and William Herbert Hunt. It is understood that the appearance of your clients on May 2 is pursuant to the subcommittee's subpena of April 23, 1980.

Signed by the chairman of the subcommittee.

Which one of you is going to proceed first? I understand you have a prepared statement. We would be very pleased to hear it.

Mr. W. H. HUNT. Yes, Mr. Chairman. I am Herbert Hunt. I have a prepared statement and I would like to——

Mr. ROSENTHAL. Go right ahead.

Mr. W. H. HUNT. First, I would like to express my sincere regrets about the misunderstanding that arose last Tuesday when I was unable to appear before the subcommittee. I certainly meant no disrespect of this subcommittee, or any member of it, by my failure to appear. On the contrary, I have great respect, not only for you as Congressmen but for your work and what you are attempting to do and accomplish with these hearings. At that period, or at that particular moment in time, I was deeply involved in attempting to settle financial difficulties. I honestly felt that if I left the negotiations at that time the repercussions for a number of people and institutions would be serious. I am sorry that this was not made more clear to the committee. I am sorry that the committee took my failure to appear to be contemptuous of the House of Representatives, which it was certainly not intended to be.

I am here today to attempt to answer all your questions as fully and as candidly as I can. Perhaps it will aid the members if I gave a brief synopsis of my experience in the subject under review.

My analysis of the recent economic history of the United States had led me to believe that the wisest investment is one which is protected from inflation. In my opinion, natural resources meet this criterion, and to that end, I have invested in oil, gas, coal, and precious metals, including silver.

I first became interested in silver as an investment, not as a speculation, in 1973. I became interested in silver after reading about it in several publications including one entitled "Silver Profits in the Seventies" by Jerome A. Smith. A study of the facts and figures led me to believe that silver was a wise, good, and conservative investment. My research revealed that the price of silver had been kept artificially low by various Government actions. Furthermore, in 1972 free world silver consumption was approximately 426.7 million ounces while production was barely in excess of 294.2 million ounces. U.S. demand in 1972 was five times domestic production.

Silver is, of course, an expendable natural resource. The prices of other expendable natural resources, in particular oil, natural gas, and coal, have risen just as the price of silver since 1973. For instance, the average wellhead value of natural gas in 1973 was 21.6 cents per Mcf, being the controlled price; today the price of deep natural gas that is not subject to regulation is $5-$6, higher than $6 in some cases. In 1973, steam coal sold for $4-$8 per ton; in 1979, it sold for $25-$30 per ton. Likewise, in the same period of time, the price of oil increased from $3-$4 per barrel to $30-$40 per barrel.

I began purchasing silver futures contracts and silver bullion in 1973. At that time, New York spot prices for silver for the year 1973 averaged $2.55 per ounce.

Again, I wish to emphasize that I am an investor, not a speculator, in silver. Throughout the seventies, I purchased and sold silver bullion and held positions in silver futures contracts on the Commodity Exchange, Inc. in New York (the Comex) and on the Chicago Board of Trade (CBOT). During that time, I stood for delivery on some contracts, but generally I continued to roll my futures positions forward. On those occasions when I did take delivery, bought bullion from other sources, or sold bullion, I am unaware of any market disruption caused by my activities.

In early 1979, I became convinced that the economy of the United States was in a weakening condition. This reinforced my belief that investment in precious metals was wise, and because of the rampant inflation, I felt the value of soft currency was in jeopardy. I did invest substantially in silver futures contracts, but generally such purchases were completed before July 1979 when silver was selling for approximately $8.50 per ounce. Well after I established such positions, the price of silver on the two major exchanges, Comex and CBOT, rose to $40 per ounce in 1980, and even for a moment went higher than that.

At no time did I attempt to corner, squeeze, or manipulate the silver market. At no time did I participate in an agreement to corner, squeeze, or manipulate the silver market. At no time did I attempt or agree with others to manipulate the silver market.

In early September, when spot silver was trading in the $11 to $12 range, the exchanges, Comex and CBOT, began taking the action which, in my view, was designed to drive the price of silver down by depriving investors of access to the market and creating market illiquidity. On September 5, 1979, the CBOT increased the margin for new silver futures contracts from $1,500 to $2,500. On the day before, the Comex had raised the original margin requirement from $2,000 to $3,000. During the 2 weeks following the initial increases, the exchanges raised the initial margin requirement to at least $20,000 per contract. These increased margin requirements were initially applied to only new contracts, but later, at least on the Comex, retroactive margin requirements were imposed which required a payment as high as $60,000 per contract. I might add on the front month, which was the delivery month, it got to where it was $75,000 per contract.

Throughout the fall of 1979, the price of silver continued to rise despite the increasingly higher margin requirements imposed by the exchanges. The exchanges then imposed position limits. On October 25, 1979, the CBOT declared a 600-contract limit on new futures positions and initially required reduction to the new limit in each contract month by February 1, 1980, by those who held contracts in excess of the 600 limit. This was later changed to April 1.

Not to be outdone, the Comex, on January 7, 1980, declared that as of February 18, 1980, a 2,000 gross contract position would be imposed. In addition, the Comex was to require a reduction of at least 10 percent in all positions which exceeded this 2,000 contract limit. I believe that was done at a later time.

In my view, it does not take a sophisticated market analyst to determine the effect of these higher margin and position-limit requirements. First, access to the silver futures market by the average investor or speculator was denied by the high margin requirements. The result: there were no small buyers and very few large buyers. Second, the position limits required large traders to dispose of their contracts. The natural result of these artificial factors was to drive the price of silver down after it drove the price of silver up. Mine was the distressful economic situation of being compelled to be a seller without a buyer.

The exchanges finally broke the silver market on January 21 and 22, 1980, with their actions. On January 21, the Comex limited trading to liquidation only. On January 22, the CBOT limited trading in January, February, and March silver futures to liquidation only. The effect of these actions was to drive the price down by making the market completely illiquid. The price of silver never again attained the levels of January 21 and 22. A comparison of the number of existing contracts, or "open interest," on the Comex and CBOT for the period September 28 through February 1 illustrates my point, that the market had become illiquid. There is a chart attached setting forth the open interest for 15 months to the back of this statement. Between September 28, 1979, and February 1, 1980, the number of outstanding contracts on the Comex dropped approximately 53 percent, and more than 69 percent on the CBOT. If you do not mind, if you will look at that chart, it is the bottom line. As you will note, that shows that in January on the Comex there were approaching 300,000 open-interest contracts, and this was pushed down and declined to where today there is just below 30,000 open-interest contracts. In other words, it has gone from 300 down to a little bit less than 30, approximately 300 to a little less than 30.

The price of silver continued to decline until late March 1980. I believe that this decline was the inevitable result of the regulatory actions taken by the exchanges.

The reason given by the exchanges for these dramatic changes in the rules, and in my opinion, manipulative actions, was that there existed an "emergency" in the market; namely, that there was a lack of silver for delivery brought about by the presumption that those holding long futures positions would stand for delivery. I submit that this really was not the reason.

The members of the board of directors, at least of Comex, were engaged or represented firms engaged in trading. Did some members of the board have an interest in forcing the market price of silver down? The Wall Street Journal, on Tuesday, April 24, 1980, reported that there were members of the Comex board who had a vested interest in seeing that the price of silver went down. These were representatives or employees of major precious metal dealers or floor brokers who had acquired short positions as the price went up. This committee should ascertain the truth of the Journal's news story. It should ascertain whether conflicts of interest existed with respect to board members and their firms.

One, were their actions between September 1979 and February 1980 "market neutral"—by that, they should not affect the price, make the price go up and down, their actions should be market neutral—or were they designed to drive the price of silver down?

Two, did the board members profit from the market?

Three, did their regulatory actions make this possible?

Four, who had access to position reports, and was this information leaked to nonauthorized persons and firms in the market? One investor company has reported gains in excess of $100 million.

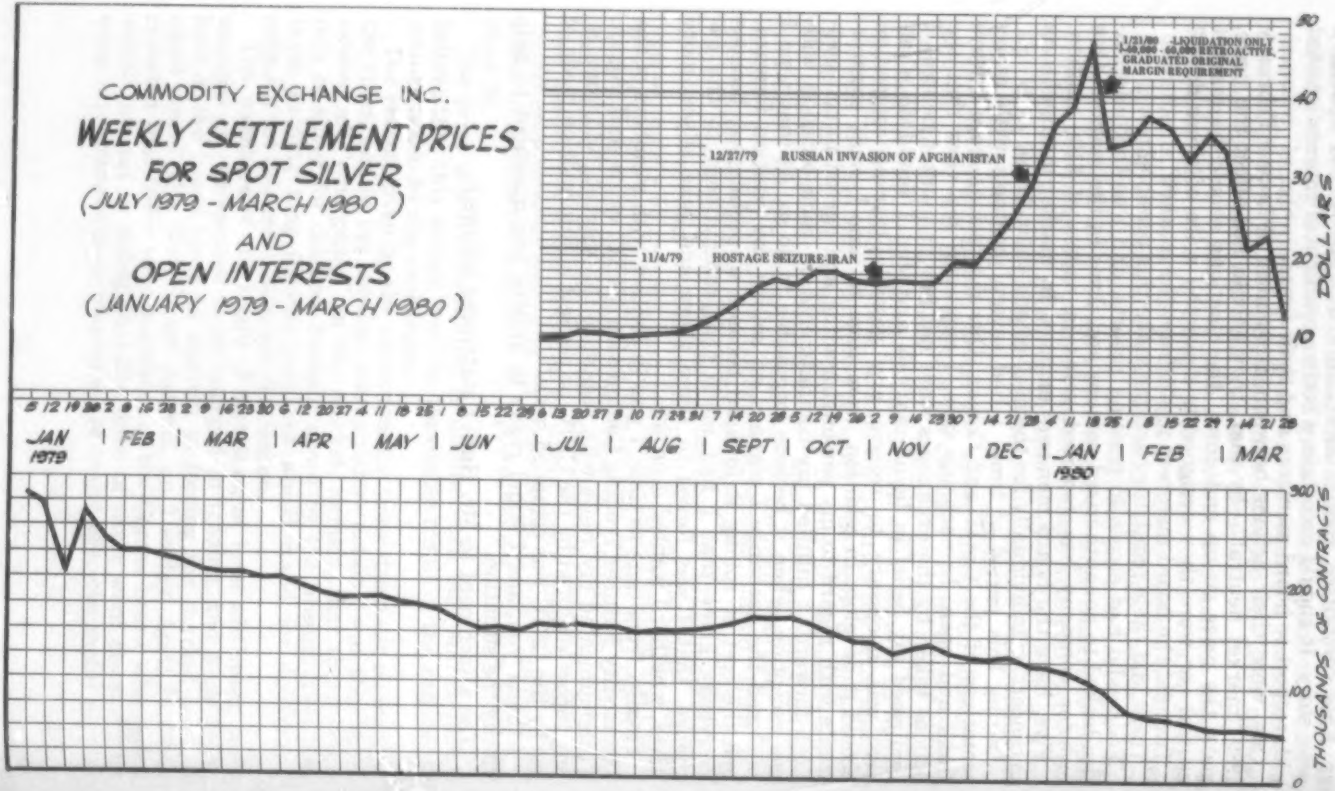
Five, have the board members engaged in market manipulation in concert or individually for themselves and their firms?

During this period of time, I had several contacts with representatives of the CBOT and Comex. Our discussions were always frank and open. In each instance, I expressed my view that the actions taken by the exchanges were not fair or market neutral. I confirmed my belief in liquid markets and that I would do whatever was necessary to relieve any possible market congestion should it develop. In addition, from time to time I made commitments with regard to my personal trading and agreed to roll positions forward. I fulfilled my commitments on each occasion with one exception, when it became impossible to do so. At that time I informed the exchange I planned on rolling my position forward, and the cost of rolling it forward became so prohibitive, because everybody knew that I had made that commitment to the exchange, that I was forced to stand there and take silver, more silver, whether I wanted it or not.

Finally, from time to time, I was in contact with members of the Commodity Futures Trading Commission (CFTC) or its staff. Again, I communicated my views with regard to the market. Additionally, any report required by the CFTC or request of information made of me by the CFTC was complied with.

I thank you, and I stand ready to answer any questions to help clarify the situation.

[The attachment to Mr. Hunt's statement follows:]



COMMODITY EXCHANGE INC.
WEEKLY SETTLEMENT PRICES
FOR SPOT SILVER
(JULY 1979 - MARCH 1980)
AND
OPEN INTERESTS
(JANUARY 1979 - MARCH 1980)

Mr. **Rosenthal.** Mr. Nelson Bunker, do you have an opening statement? You want to say anything?

Mr. N. B. **Hunt.** I will adopt and subscribe to my brother's statement, and let me apologize to the committee that we were not able to come Tuesday. I am sorry there was a misunderstanding. I am pleased to be here today.

Mr. **Rosenthal.** Mr. Hunt, one of the things that happens when you have a hearing of this type that receives a good deal of public attention is that individuals from all over the country communicate all kinds of rumors and alleged facts and things of that nature, and that has happened to an extent. There was one thing I felt somewhat obliged to ask you: Are you now or have you ever been involved in a business relationship to purchase silver, or any kind of business relationship, with a current Member of Congress?

Mr. W. H. **Hunt.** I have not.

Mr. **Rosenthal.** And would that be true for you, too, Mr. Hunt?

Mr. N. B. **Hunt.** That is correct, I have not.

Mr. **Rosenthal.** Now, you began your silver enterprises quite thoughtfully in 1973, and apparently your interest in silver continued, let's say, to January 1, 1980. Can you tell us the progression of your holdings, both financial and physical, from the time you began until January 1, 1980?

Mr. W. H. **Hunt.** Let me correct you. I am still an investor in silver and still have silver positions.

Mr. **Rosenthal.** I wanted to take the segment from January 1 to now in a separate question. I would like to get, and I think what the committee ought to know exactly is, what your position was at the beginning of this year, both your financial commitment and your physical holdings of silver?

Mr. W. H. **Hunt.** I am not sure I can answer that question. Over that period of time my commitments in silver have varied up and down and I don't have with me today exactly what my positions were at any given time between 1973 and January of 1980.

Mr. **Rosenthal.** Do you have any records with you today that would indicate what your physical holdings of silver, either you or your brother or the Hunt enterprises, or any of the companies that you are principally involved in, how much silver they physically held as of January 1, 1980?

Mr. W. H. **Hunt.** Let me make it very clear. I look after my own investment in silver, I do not stay apprised of what my brothers own and I don't have any records with me today that reflect exactly what my positions were in future contracts and silver, bullion, actually.

Mr. **Rosenthal.** It is distressing that you didn't bring with you some records. We purposely avoided serving a subpena duces tecum in the hope that there would be a willingness to produce records.

It is important. Let me tell you why so you understand. Chairman Volcker, in testifying on Wednesday, said, and I quote, "There is evidence indicating an attempt to control the supply of a significant commodity."

If my memory serves me correctly, it was his view the Hunts and Hunt-related enterprises controlled physically about two-thirds of the world's silver, and it is important for us to know if his version

best copy available

is correct and exactly what your position is as far as your physical inventory on January 1, 1980.

Mr. W. H. **Hunt**. At no time did I come anywhere close to owning two-thirds of the world's silver.

Mr. **Rosenthal**. Just for the sake of discussion, you and your brother, and then you have another brother, Lamar Hunt?

Mr. W. H. **Hunt**. That is correct.

Mr. **Rosenthal**. And you have lots of other diversified interests. All of the Hunt-related activities, on January 1, 1980, could you tell us what the percentage of either United States or world silver inventory you controlled or owned?

Mr. W. H. **Hunt**. I cannot because I don't have the compiled figures. I can assure you it was nowhere near two-thirds of the world's silver, because there is a tremendous amount of silver in the world.

Mr. **Rosenthal**. Well, we are at a loss, we are in the dark, to understand what percentage you did control. Are you willing to speculate? Is it less than 60 percent?

Mr. W. H. **Hunt**. I am sorry, I didn't understand the figure.

Mr. **Rosenthal**. Well, it is absolutely urgent that we know, for example, what the vault receipts both here and abroad were for silver under your control, the silver under control of the Saudis and the International Metal Investment Corp., and the syndicate which proposed the silver backed bonds of March 27-28, silver through Gulf Resources or other outstanding contracts of delivery for silver—for the Congress to understand whether or not there was speculation of one kind or another, or an attempt to control the market.

It is absolutely urgent that we understand if any one group of investors in fact did have physical control of the market.

Mr. W. H. **Hunt**. Well, your question is a very long question. You mentioned Gulf Resources. I don't own any interest in Gulf Resources.

Mr. **Rosenthal**. Let me try to make it as simple as possible, and I apologize for my inability to articulate with more precision the nature of my inquiry.

Can you tell us how much silver you or your brothers, or all enterprises controlled by you, owned on January 1, 1980?

Mr. W. H. **Hunt**. I do not have those figures.

Mr. **Rosenthal**. Do you have those figures somewhere, anywhere?

Mr. W. H. **Hunt**. I have the figures that involve me, yes.

Mr. **Rosenthal**. Why don't you tell us. Should we do this piecemeal?

Mr. W. H. **Hunt**. I am not trying to be unresponsive but I don't have those figures with me. I can't carry—I have been in the market since 1973, and the position changes on a daily basis and I——

Mr. **Rosenthal**. Well, I am going to ask you now to furnish for the record all the information and data concerning the request I have made; that is, to be specific, so that the record is clear for both of us, would you tell us the amount of silver that you yourself owned and/or controlled by receipts or any other device or method as of January 1, 1980.

Mr. W. H. **Hunt**. I will be glad to do so.

Mr. **Rosenthal**. Can you tell us whether you personally controlled 25 percent of the world's silver as of January 1, 1980? Would that be a fair estimate?

Mr. W. H. **Hunt**. I am sure that I did not.

Mr. **Rosenthal**. Mr. Hunt, Nelson Bunker Hunt, how do you respond? How would you respond to the question asked your brother?

Mr. N. B. **Hunt**. I didn't own any amount of that size.

Mr. **Rosenthal**. Are your holdings kept separately, the financial records?

Mr. W. H. **Hunt**. Yes sir.

Mr. **Rosenthal**. There is no joint venture or joint enterprise or joint partnership?

Mr. W. H. **Hunt**. That is true.

Mr. **Rosenthal**. You take Placid Oil, you have separate ownership in that, too?

Mr. W. H. **Hunt**. I own no interest in the Placid Oil Co.

Mr. **Rosenthal**. Does Mr. Nelson Bunker Hunt own any interest in Placid Oil?

Mr. N. B. **Hunt**. No, I don't. Placid Oil is owned by trust estates. Placid Oil is owned by trust estates, members of the Hunt family and——

Mr. **Rosenthal**. Are you a beneficiary of Placid Oil?

Mr. N. B. **Hunt**. Yes, I am a beneficiary of one trust.

Mr. **Rosenthal**. Are you, Mr. Hunt?

Mr. W. H. **Hunt**. I am a beneficiary of a trust which is a stockholder in Placid Oil Co.

Mr. **Rosenthal**. Is the trust a 100-percent stockholder of Placid Oil.

Mr. **Goldburg**. I didn't understand the question.

Mr. **Rosenthal**. Does the trust have 100-percent stock ownership in Placid Oil?

Mr. W. H. **Hunt**. Does my trust have 100-percent stock ownership?

Mr. **Rosenthal**. The trust you are the residual beneficiary of?

Mr. W. H. **Hunt**. No, it does not.

Mr. **Rosenthal**. Who are the trustees of that trust?

Mr. W. H. **Hunt**. The trustee of my trust is Stephen Sands.

Mr. **Rosenthal**. And the trustee of your trust, Mr. Nelson Bunker Hunt?

Mr. N. B. **Hunt**. Tom Hunt.

Mr. **Rosenthal**. He is a cousin?

Mr. N. B. **Hunt**. Yes, that is right.

Mr. **Rosenthal**. What we are trying to get, and it is very difficult to dig through this in a non-lawyer-like fashion, we know that people of substance such as yours, and, as a matter of fact, other people, do have a number of, not devices, but legitimate mechanisms for dividing ownership, and what we are interested in, and we are assuming that with divided ownership you do have some joint interest in whether the price goes up or down. And the character of the question I am asking is if you take all of the Hunt enterprises together, including trusts and residual beneficiaries and life interests, and all the other things that lawyers are so skillful at putting into agreements, we are trying to find out how much of the world's silver you controlled on January 1, 1980.

Mr. GOLDBURG. May I interrupt for a moment?

Mr. ROSENTHAL. Please.

Mr. GOLDBURG. Mr. Nelson Bunker Hunt testified as to who the trustee of his trust was. It happens that, to correct the record, a James Parker, for the record, is trustee of his trust.

Mr. ROSENTHAL. Let me tell you, we want to find out later on today, what is happening about the $1.1 billion loan that Chairman Volcker is apparently interested in. Is that a loan to Placid Oil?

Mr. W. H. HUNT. That is correct, that is my understanding.

Mr. ROSENTHAL. You see, Mr. Volcker quite innocently uses your name and Placid Oil together very freely and legally. I presume he is incorrect?

Mr. W. H. HUNT. That is correct.

Mr. ROSENTHAL. Now the loan for Placid Oil, what is that all about? Are you a friendly family?

Mr. W. H. HUNT. At times we get along fine.

Mr. ROSENTHAL. In other words, you can understand the character of the question. I am trying to find out whether this Hunt family really puts all their assets together, not in terms of legal beneficiaries but in terms of interest and control and how it impacts on events in our society.

Mr. W. H. HUNT. The answer to that is they very definitely do not.

Mr. ROSENTHAL. The loan to Placid Oil, is that something to benefit you individually?

Mr. W. H. HUNT. No, Placid Oil Co. is making borrowings on their oil and gas properties for a loan.

Mr. ROSENTHAL. Did Placid Oil own any silver futures?

Mr. W. H. HUNT. I think they may have a very small futures position.

Mr. ROSENTHAL. If you can speculate why does Mr. Volcker think that the $1.1 billion loan to Placid has something to do with your future dealings?

Mr. W. H. HUNT. I don't know why he speculates.

Mr. ROSENTHAL. He has spent 45 minutes in testimony talking about—Mr. Levitas.

Mr. LEVITAS. Mr. Chairman, because I think it may have derived from some events that occurred at Boca Raton, were either of you gentlemen at Boca Raton?

Mr. W. H. HUNT. Yes, I was at Boca Raton.

Mr. LEVITAS. And did you have discussions with banks there about loans?

Mr. W. H. HUNT. Yes, I did.

Mr. LEVITAS. Were those loans to be made for your account or for the account of any member of your family, or for any company in which you had a direct or indirect interest?

Mr. W. H. HUNT. When I was at Boca Raton, I discussed with the bankers loans for myself.

Mr. LEVITAS. And for no other entity or no other person?

Mr. W. H. HUNT. That is correct.

Mr. ROSENTHAL. Was Mr. Volcker present with you in Boca Raton?

Mr. W. H. Hunt. I have never met Mr. Volcker.

Mr. Levitas. You were at a room in Boca Raton with Engelhart and some bankers?

Mr. W. H. Hunt. Yes, sir.

Mr. Levitas. Did you see Mr. Volcker in the hotel?

Mr. W. H. Hunt. I did not, no. I heard that he was there. But I did not see him.

Mr. Levitas. Are the Hunt brothers or sisters or cousin Tom, are they on the board of directors of Placid Oil?

Mr. W. H. Hunt. I am not on the board. I believe that Lamar Hunt is on the board.

Mr. Levitas. Let me put it in simple terms, do the Hunts control Placid Oil?

Mr. W. H. Hunt. The Placid Oil Co. is a corporation and is ruled by its board and that board includes both non-Hunts and Hunts.

Mr. Rosenthal. There are many lawyers on this panel and we all understand these terms, but do the Hunts control Placid Oil?

Mr. W. H. Hunt. I am sorry, I don't know how to answer your question. The Hunts, if you are talking about these Hunts we do not control Placid Oil.

Mr. Rosenthal. I am talking about Hunts as a filial group, all of the Hunts.

Mr. Goldburg. Mr. Chairman.

Mr. Rosenthal. How would you answer that Mr. Nelson Bunker Hunt, do the Hunts control Placid Oil?

Mr. N. B. Hunt. Well, it is 100 percent owned by trusts which are owned by the Hunt family.

Mr. Rosenthal. I think you have answered the question.

Mr. N. B. Hunt. So there are non-Hunts that are directors.

Mr. Rosenthal. There are non-Hunt family directors but they are not the financial beneficiaries of the trust, the non-family directors?

Mr. N. B. Hunt. That is correct.

Mr. Rosenthal. Why did your brother have such trouble with that simple question?

Mr. N. B. Hunt. I haven't agreed that the Hunts control it, it is controlled by trusts of which the Hunts are beneficiaries.

Mr. Rosenthal. I think we understand. The way we will do it—my time has expired—each of the members will have 10 minutes. After everyone has finished, we will rotate again.

Mr. Jefferies.

Mr. Jefferies. Good morning.

Mr. Chairman, at the outset, I would like to make an observation. While it is important that we carefully consider what has been happening recently in the silver markets—I must say I am impressed by two important considerations:

First, in these hearings and other hearings on Capitol Hill, I have been struck by the almost automatic assumption on the part of many here in Washington that increased Government regulation is the answer to any perceived problems.

Second, I have been impressed by the lack of understanding about of how commodity markets actually operate. For example, there is persistent confusion about the different functions of margins as it relates to the purchase of securities on credit and its function in futures transactions as a performance bond. To the extent these hearings contribute to our understanding of the market, and its potential problems, I am delighted that we are here.

But so far in these hearings, only Governor Volcker has expressed serious concern about the possibility of action preceding wisdom. I hope we don't find ourselves expanding the scope of regulation for its own sake, and leaving the details to be worked out later downtown by people who deal mostly in abstractions.

In this regard, Governor Volcker expressed concern that hasty action on our part might drive the commodities industry to overseas markets where we could end up with a net loss of regulatory control and be even more vulnerable to market disruptions which are clearly beyond our reach.

Would our witnesses comment on that potential problem?

Mr. W. H. **Hunt**. Mr. Jeffries, I would have to say that I agree with you. The best market is one that is a free market, and not subject to overregulation. The whole silver situation evolved from Government policies over the last 100 years. By that, I mean the recent price explosion.

If you will go back to the 18th century the coinage value of silver was $1.29, and this was a really constant price until about 1860 when the western mines, the silver in the Western States started being mined. There was so much of it mined that the price started to drift lower down to 64 cents, et cetera. So there was act after act passed to try and support the price and try to keep it in the $1.29 range.

These acts involve a government buying silver dollars, buying silver and issuing silver certificates, buying silver, melting it down, sending it to India, et cetera.

The net results was that over a very short period of time the U.S. Government accumulated over 3 billion ounces of silver.

Now, 2 billion of that was accumulated, well 3 billion of it was accumulated I believe between 1934 and 1937, or the bulk of it between 1934 and 1937. With World War II, 900 million ounces of that silver was used in international transactions. Then after World War II, there came a time when the price of silver, due to the increased use, from the tremendous expanded uses of it, in electronics and other areas, greatly accelerated the use of silver.

Mr. **Jefferies**. May I cut in just a moment?

Mr. W. H. **Hunt**. Right.

I understand what you are trying to get to today. I am trying to get us there.

Mr. **Jefferies**. All right.

Mr. W. H. **Hunt**. I won't take but another minute.

The result was that the Treasury started selling off this silver and in 10 years dumped 2 billion ounces of silver on the market. There was more because they were also selling melted coin. That literally was more than the United States consumed, and so we had to go through a period when that was used up. Essentially, that is why the silver prices started to rise in 1973 and have been going up ever since.

Mr. **Jefferies**. OK.

Mr. W. H. Hunt. And I agree with you, the interference in the market has brought about a tremendous rise and very frankly, this price rise went much higher than it should have gone. It went higher because the market became illiquid due to the Comex regulations establishing high margin. Literally the high margin or threats of high margins were announced in advanced, making the price go up.

Some tried to get out and once it became obvious they couldn't get out, it made the price fall on the other side because the longs could not get out either.

Mr. Jefferies. As you know, it is generally understood that only a small fraction of the physical commodity is actually delivered or received against the futures contract when that contract expires.

Some people in the industry have argued that the futures markets as they presently exist are not really structured to handle the large magnitude of physical deliveries which have actually taken place in recent months.

As you had started to acquire physical inventories of silver, did it ever occur to you that your scale of operations might place a strain on the market system in a way that the market really couldn't sustain? Would you respond to that concern?

Mr. W. H. Hunt. It did not and I think the facts are that the market was able to deliver silver.

Mr. Jefferies. As a result of these events, in your opinion, who has been hurt? Who has been hurt or who has been hurt the worst?

Mr. W. H. Hunt. Well, at the moment, I think you are looking at him.

Mr. Jefferies. Who else has been hurt that you know of? Anyone?

Mr. W. H. Hunt. Well, I think basically the market, the way it was structured and manipulated, due to the margin requirements, et cetera, I think both sides were hurt. I think small traders were hurt as it went too high, and the large traders were hurt as it became too low

Mr. Jefferies. Have there been any commodity firms, or security firms, hurt to some degree?

Mr. W. H. Hunt. I don't know.

Mr. Jefferies. Were you informed of the possible risk involved in trading commodities, have you been informed about that?

Mr. W. H. Hunt. Yes sir, I have had to make many a margin call.

Mr. Jefferies. All right. Let's get back to this potential overseas problem. Do you feel that a truly significant volume of our futures trading may be moving to overseas exchanges?

Mr. W. H. Hunt. I think that is taking place right now.

Mr. Jefferies. It is already in process?

Mr. W. H. Hunt. Well, of course, there has been a market overseas. You must realize that.

Mr. Jefferies. I am talking about those who have traded in the United States, but are now starting to trade overseas?

Mr. W. H. Hunt. Yes sir, I think you are seeing this take place to a limited degree.

Mr. **Jefferies.** And what is the real reason for that movement overseas in your opinon?

Mr. W. H. **Hunt.** Basically the markets here are illiquid and are not functioning. In other words, with the regulations that were put into effect, the markets were made illiquid. The open interest came way down and very frankly I think there is a loss of confidence in the markets due to the fact that the rules were changed so often and the market was not allowed to function.

Mr. **Jefferies.** And you say this loss of confidence has been prompted by the threat of increased Government involvement?

Mr. W. H. **Hunt.** I did not hear you.

Mr. **Jefferies.** You are saying that because of increased Government involvement, there has been a corresponding loss of confidence in the market?

Mr. W. H. **Hunt.** I am saying that mainly because of the Comex involvement.

Mr. **Jefferies.** All right.

Mr. W. H. **Hunt.** The exchange involvement.

Mr. **Jefferies.** The exchange involvement.

I think that is all I have.

Mr. **Rosenthal.** Mr. Atkinson.

Mr. **Atkinson.** Mr. Chairman, I too, like Mr. Jeffries, have an observation on the lighter side maybe. These last couple of days all these hearings kind of remind me of the TV serial, the Lone Ranger and Silver, and who are these masked men, that type of scenario.

I would like to ask you, Mr. Hunt, who is arranging these loans, and I would like to know further, since you bought considerable silver between the time of January 1979 and January 1980, when the price went from $6.50 to $50.30, what your margins of profits were? And then upon dropping of the market from that $50 down to still a higher figure, somewhere around $10 or $12, what have your losses been?

The reason for the question is, if you reap benefits or you suffered losses, what is the difference, how were you impacted as a family or as an individual?

Mr. W. H. **Hunt.** Congressman Atkinson, that is a long question. Would you mind letting me have the first part first?

Mr. **Atkinson.** The arrangements being made for your loans, as I understand it, some of your partners are the Arab sheiks, European banks based in Switzerland, including a Soviet-owned bank pronounced Wozchod. Are these partners of yours in the purchase of silver, or arrangements for loans to offset your losses?

Mr. W. H. **Hunt.** No.

Mr. **Goldburg.** Congressman, I think there is some confusion in terms of the use of the word "partners," and the context in which you put the question. If you could attempt, it is a difficult one to remember.

Mr. **Atkinson.** Any association at all. I am one of the persons up here who doesn't happen to be a lawyer. Maybe my terminology, the way I phrase it may not be——

Mr. **Goldburg.** You are doing pretty well, sir.

Mr. **Atkinson.** If you answered that question, I can pass on it. I didn't want to debate it. I wanted certain questions answered for the record, because we are on limited time. So that is the one question.

The other question that I have is this. In your testimony, Mr. Hunt, you said "at no time did I attempt to corner, squeeze or manipulate the silver market, at no time did I agree with others to manipulate the silver market."

Regarding the silver market, weren't 50 letters written by the Hunts to Saudi Arabia in an attempt to raise, I would assume, the value of silver?

Mr. W. H. HUNT. I didn't quite understand your question, because I didn't hear you. Would you mind just rephrasing?

Mr. ATKINSON. What I am really trying to say, there were statements made that you attempted——

Mr. W. H. HUNT. Yes, I heard that. It was after that.

Mr. ATKINSON. There were numerous letters written to Saudi Arabians. That is the information we have. The letters were written by your family, or by you or by those who represent you concerning the dealings in the silver market. I would suspect that in these instances there would be some determination on your part to either manipulate or to try to impact the market in some way. What would be the content of the letters if that is a fair question?

Mr. W. H. HUNT. I am not sure what letters you refer to. I don't know of what letters you are talking about, Congressman.

Mr. ATKINSON. According to the testimony of Mr. Volcker, he stated the other day that there was some kind of partnership agreement between the Hunts and some foreign interests?

Mr. W. H. HUNT. All right, well, I know what you are talking about now. There is a company, International Metals Investment Corp., that is owned by Hunt interests. It is a corporation and it also has ownership by Saudi individuals.

Mr. ROSENTHAL. Is that an offshore corporation in Bermuda?

Mr. W. H. HUNT. It is a Bermuda corporation.

Mr. ATKINSON. The information that we referred to is in the International Money Management Business Week, April 14, 1980, "Silver Leaves a Global Casualty List." That is where the Hunts wrote 50 letters to wealthy Saudis explaining why silver was bound to rise and asking them to join with him in the syndicate.

Mr. W. H. HUNT. I did not write any letters, Congressman.

Mr. ATKINSON. Mr. Nelson Bunker Hunt, have you?

Mr. N. B. HUNT. No, the same with me. I wrote no letters to anyone.

Mr. ATKINSON. Or how about other members of the Hunt family?

Mr. N. B. HUNT. As far as I know, they didn't. I am pretty sure they wouldn't have or did not.

Mr. ATKINSON. We have other information. As the chairman stated earlier, there is a lot reported in the media, accuracy of it or its sources are hard to determine many times. Going back to the original question—what were your profits and what were your losses as far as the silver commodity market was concerned from January 1979 through January 1980 and then in the decline through March 27, 1980?

Mr. W. H. HUNT. I have not figured what those profits or losses are, but as I stated in my opening statement, the bulk of my position was acquired prior to July 1979, and literally you don't have a profit until you realize it and just because the market went up and down——

Mr. **Atkinson**. You weren't selling off as the market was dropping?

Mr. W. H. **Hunt**. That is correct. I did not sell off until after it dropped.

Mr. **Atkinson**. When it dropped it still leveled at $10 or $12. The initial prices were $6.50. Was there any margin of profit at all? The reason for the question is this—most of the talk is about a loan, with other statements being made that all of the loans have been paid off.

Are you really still in need of a loan to the extent of the dollar figure we have been hearing?

Mr. W. H. **Hunt**. Well, I think there is some confusion. I am not getting a loan. I still own silver, it is still financed, but the loan that we keep hearing about is a loan for Placid Oil Co.

Mr. **Atkinson**. Well, does it find its way into the problems that you are having with silver. Even though it comes in the direction of Placid Oil?

Mr. W. H. **Hunt**. Pardon me a second, may I visit?

Mr. **Atkinson**. Certainly.

Mr. W. H. **Hunt**. Congressman, it does have a relationship to the silver positions.

Mr. **Atkinson**. Fine.

Mr. **Rosenthal**. What is the relationship?

Mr. W. H. **Hunt**. Let me see if I can clarify for you the confusion that exists.

Placid Oil Co. has negotiated a loan that is a 9-year loan. This loan is for their overall operations. It is secured with oil and gas properties. The proceeds are to be used for a partnership which Placid will be the general partner and I and Bunker Hunt and Lamar Hunt will be limited partners.

Into that partnership will go many assets which will include not only silver, forward contracts for silver, but also coal properties, stocks, a number of other different securities, and assets. And there is substantial equity in those cases, in excess of $450 million.

Mr. **Deckard**. Will the gentleman yield? Will any of the proceeds of the loan be used to purchase by Placid Oil additional stock in Gulf Resources?

Mr. W. H. **Hunt**. No.

Mr. **Deckard**. Are there any covenants in that 9-year loan that would prohibit speculation in silver and/or other commodities?

Mr. W. H. **Hunt**. I think there are. I have not seen the loan itself, because it is Placid Oil Co. that is doing the borrowing.

Mr. **Deckard**. Thank you.

Mr. **Rosenthal**. The time of the gentleman has expired. Mr. Deckard.

Mr. W. H. **Hunt**. Pardon me, my counsel just pointed out that that is the case because there are covenants in my partnership agreement that the partnership will not acquire additional stocks, et cetera.

Mr. **Deckard**. Does it require you to dispose of any existing silver holdings that you have?

Mr. W. H. HUNT. The partnership arrangement does provide for a disposal of the assets over an orderly period of time.

Mr. DECKARD. I would like to thank both of you for your presence this morning, and your responsiveness in the questions that have been asked. Mr. Nelson Bunker Hunt, although not submitting a separate statement, has indicated that your statement reflects his views as well, and on page 2 of your statement you say that "I am an investor. I am not a speculator." I would like to ask Mr. Nelson Bunker Hunt whether that statement applies equally as well to him.

Mr. N. B. HUNT. Yes, it does. I consider myself strictly an investor in silver, and I have no interest in speculating at all.

Mr. DECKARD. Mr. Nelson Bunker Hunt, does this indicate you feel that speculation carries the possibility for possible injury to market processes?

Mr. N. B. HUNT. Well, no. Yes and no I guess would be the better answer. In other words, I think any market needs to have the right of free trade, and so I guess you can have either too much selling or too much buying, which can affect the market.

Mr. DECKARD. Of course, I know the dividing line between investment and speculating can sometimes be a pretty gray area, because even an investor, obviously, is investing his resources in hopes of gaining a greater return in the future. I would like Mr. Nelson Bunker Hunt, if you will, to define the differences as you see them between an investor and a speculator.

Mr. N. B. HUNT. Well, I expect Webster's dictionary could do a much better job than I, but I will try. A speculator is someone who buys on a rather short-term basis with the idea of selling and making a profit, or he sells with the idea of buying and making a profit on a short-term move of the market, maybe a week, maybe a month, maybe 2 or 3 months, whereas an investor I look at as someone who buys on a very long basis, a year and a half, 2 years, maybe 10 years.

Mr. DECKARD. But, on the other hand, a speculator could enter into a speculative proposition on a long-term basis. There are devices for accomplishing this that have been attempted in the past through perhaps surreptitious buying over a long period of time, and then at a certain point in time making it known that large purchases have been made, and are in the hands of one individual or one small group of individuals, thereby forcing up the market prices, and at the same time as that occurs, effect a surreptitious exit from the market.

Is that a possibility, that a speculator could enter into speculation on a long-term basis as well as short term?

Mr. N. B. HUNT. That is a little too involved for my chain of thought. I wouldn't want to speculate on whether it could be done or not. Actually, in the kind of markets we have had the last 3 months, there would be no way to sell, because the market was virtually illiquid and you couldn't sell any size contracts at all.

Mr. DECKARD. Mr. Volcker is of the opinion that in some manner this $1 billion loan will force liquidation of your silver holdings. The opposite would seem to be true.

I recognize this morning, that just by virtue of your appearance here this morning and statements that you make, will have an effect on the market, an effect on the value of your own holdings and the values of others. I am going to attempt as much as possible to stay away from specific dollar amounts as to the dollar amounts that you owned at a certain period of time, that you own now, and specific dollar amounts that you may have gotten rid of at any one point in time. I would prefer to speak perhaps in percentages, which might not have as much of an impact. So I will express my question this way:

To what extent have your silver holdings diminished since the price decline? To what extent have they diminished since the terms of the recent loan were made?

Mr. N. B. HUNT. Well, since—when the margin call situation occurred, there was some liquidation on the part of the brokerage houses, and it might, for myself it might have amounted to 40 or 50 percent, but it was a very forced liquidation at a very low price.

Mr. DECKARD. I would like in a moment to get into those emergency measures, because I do think that you have a legitimate point that rules were changed in the middle of the game, and that the precipitious decline in silver values came about as the result of those changes rather than perhaps because of some of the actions that you have taken. But before I get to that, Mr. Volcker the other day in response to a question of mine, indicated that he didn't think it was healthy for one person or one small group of individuals to hold such massive positions in silver.

Would you agree or disagree with that assessment?

Mr. N. B. HUNT. Well, I guess he was right. It wasn't too healthy to the holder. The market came down.

Mr. DECKARD. Another question has arisen. Why the necessity of a billion-dollar loan when your obligations as the result of the increased margin calls had apparently been met?

Mr. N. B. HUNT. Well, I think it was felt that there was additional money required, and that was the best way to resolve this problem.

Mr. DECKARD. Required for what purpose or purposes?

Mr. N. B. HUNT. Well, to pay off existing loans, and existing commitments.

Mr. DECKARD. Do either of you own a seat on any of these exchanges?

Mr. W. H. HUNT. I do not.

Mr. N. B. HUNT. No, I don't have one.

Mr. DECKARD. As far as you are aware, are all members of the exchanges equally informed and consulted as to the actions that are to be taken? For example, changing margin requirements and positions.

Mr. W. H. HUNT. The board of directors of Comex, as I understand it, make the decisions, and they are done at board meetings at which all the board members are present, if they want to attend, but I really am not involved, am not on the board, so I can't tell you whether that is really the way it functions or not.

Mr. DECKARD. On page 4 you speak at great length about some of these emergency measures that were taken by both of the exchanges, CBOT and Comex. Do you think—I don't know whether you have already indicated this—that the decisions of these exchanges to take these emergency actions were disinterested. I think you would agree they were not disinterested?

Mr. W. H. Hunt. I think the parties taking those decisions were not disinterested parties.

Mr. Deckard. Because some members of the exchanges held large short positions and stood to lose as you gained, they were about to be squeezed. They also stood to gain as you lost. Do you think there are any antitrust considerations that might be involved in their decisions to change the rules, thus benefiting themselves in at least one case to the extent of $100 million, as I understand it?

Mr. N. B. Hunt. I am not familiar with the antitrust laws, but I did read that Occidental Petroleum made $130 million or $160 million shorting the market. I don't know whether they did that on inside information or not.

Mr. Deckard. Do you think it would be equally useful for us to meet with those who did hold the large short positions, and inquire of them as to how they arrived at their decisions to take these actions which were apparently so beneficial to them, and so destructive of your financial interests?

Mr. N. B. Hunt. I would be interested in knowing, you know, just how much money the people who write the rules and change the rules in the middle of the stream made.

Mr. Deckard. Should shorts be required to have physical possession in order to avoid the possibility of being squeezed? Would that be a beneficial approach?

Mr. N. B. Hunt. I would say that that is something to consider, yes.

Mr. W. H. Hunt. I would disagree.

Mr. Deckard. Would you state your disagreement?

Mr. W. H. Hunt. Well, I think for the market to be liquid you must have every type of trader in the market, and if someone wants to sell silver on the feeling that he can buy it cheaper later on and meet that call, I think that has to be provided for.

Mr. Deckard. In order to avoid a possible conflict of interest that we are making reference to here, do you think it would be helpful to have the CFTC set margin requirements to provide some type of constancy to the market by which investors can make rational planning decisions for the future?

Mr. W. H. Hunt. Not necessarily, Mr. Deckard. Things move so fast I am not sure that the CFTC could respond fast enough to be in the day-to-day operations. The whole point of page 4, which you referred to, is basically, I think, that the board of Comex was in position to affect that market and had a conflict of interest. I think their actions speak for themselves. They did affect that market and therefore I think that needs to be looked at.

Mr. Deckard. Thank you.

Mr. Rosenthal. Mr. St Germain.

Mr. St Germain. Thank you, Mr. Chairman.

Mr. Nelson B. Hunt, according to a New York Times story March 1, 1980, it is alleged that when the dust settled early this month "Mr. Hunt reportedly owned or controlled through various family interests between 150 and 180 million ounces of silver." Is that an accurate figure?

Is it within the ballpark or is it completely and totally inaccurate?

Mr. N. B. HUNT. As far as what I had personally, it is quite inaccurate, I would think.

Mr. ST GERMAIN. I will repeat. "Mr. Hunt reportedly owned or controlled through family interests * * *." In other words, yourself, your brother W. H., and some of the trust corporations involved, over which you do exercise a certain amount of control?

Mr. N. B. HUNT. Well, I have no control over my brother, and he does what he wants.

Mr. ST GERMAIN. I am impressed. I am truly impressed by that allegation, sir. If that be the case, let's get to the loan now. The restructuring, as Chairman Volcker of the Federal Reserve Board stated, of the loans now going on, are still being negotiated. The figure that Chairman Volcker used was $800 million. There are some who state the figure is probably $1 billion. The loan that Placid Oil is now negotiating with the consortium of banks is in what amount, Mr. W. H. Hunt?

Mr. W. H. HUNT. I don't know where the exact amount is going to end up. As I say, Placid Oil Co. is handling that, and I don't have anything to do with that arrangement. My involvement is with the partnership that will be created.

Mr. ST GERMAIN. Right, and the partnership—is Chairman Volcker of the Federal Reserve Board completely and totally in the dark here? Is he totally misinformed? It seems to me the banks, according to what he told us, are in touch with the Federal Reserve Board. They do have an interest in what is going on here, because of the amount of money involved.

Now, he stated that the purpose of this loan, from a group of banks in the amount of, as he alleged, $800 million, was for the purpose of restructuring loans to back up or to shore up the speculation or, as you would prefer to put it, the investment in silver futures and contracts.

Now, is that in error?

Mr. W. H. HUNT. I don't——

Mr. ST GERMAIN. Using legal devices, Mr. Hunt, that is understandable.

Mr. W. H. HUNT. No, but——

Mr. ST GERMAIN. But the end product, the end result, the reason for the loan is what?

Mr. W. H. HUNT. Congressman St Germain, I don't know what Mr. Volcker's involvement is in it, because I am not involved in that end of it. I can tell you about the partnership portion of it, which the funds, some of the funds, will be used for. But I literally am not involved in the negotiation of the loan as such. That is handled by Placid Oil Co.

Mr. ST GERMAIN. Mr. W. H. Hunt, did I understand you correctly earlier in your testimony, in answering questions, to state that you are not out of the silver market, but are indeed still trading in silver and intend to continue to trade in silver?

Mr. W. H. HUNT. No, I did not say that. I said I still owned silver.

Mr. ST GERMAIN. Yes, and are you still trading in silver futures?

Mr. W. H. HUNT. Am I still trading futures contracts?

Mr. **St Germain.** Correct.

Mr. W. H. **Hunt.** No, I am not trading futures contracts. I still have some futures contracts positions, but it is essentially a balanced position, where I am long one month and short another for a net zero.

Mr. **St Germain.** Now, you say that the partnership that will result, and to which the money being borrowed by Placid Oil from this consortium of banks is a partnership between Placid Oil and yourself. You are a partner to that agreement?

Mr. W. H. **Hunt.** That is correct.

Mr. **St Germain.** And Mr. N. B. Hunt, is he a partner to that agreement?

Mr. W. H. **Hunt.** It is my understanding, yes.

Mr. **St Germain.** And Mr. Lamar Hunt?

Mr. W. H. **Hunt.** Yes.

Mr. **St Germain.** Yes. All right, now, that money that is going into that partnership, is some of it going to be used to repay Bache & Co., Bache, Halsey, Stewart? They were $230 million short a little while back, and this is what caused the ripple across the country and the concern?

Mr. W. H. **Hunt.** No.

Mr. **St Germain.** Do either of you owe substantial amounts of money to Bache, Halsey and Stewart at this time that would be repaid by one of these banks loans?

Mr. W. H. **Hunt.** Does who?

Mr. **St Germain.** Either yourself——

Mr. W. H. **Hunt.** I think that I have some silver that is financed with Bache, but is a fully collateralized loan.

Mr. **St Germain.** But they need the money?

Mr. W. H. **Hunt.** I think that the banks which are loaning them the money have asked that the loan be paid off when it comes due, and the partnership that is envisioned will pick up any financing that exists on the existing silver bullion that I own, and for that matter I think that Mr. Hunt, Bunker Hunt, owns some. In effect, funds will flow to a Bache, or whoever has financed silver, and then from them to the banks that have financed them.

Mr. **St Germain.** Now, Mr. W. H. Hunt or Mr. N. B. Hunt, do either of you or both of you hold a position in the Bache Co., approximately 5.6 percent?

Mr. W. H. **Hunt.** I own some stock in Bache Company, and it is something slightly over 3 percent, I believe.

Mr. **St Germain.** Mr. N. B. Hunt?

Mr. N. B. **Hunt.** Yes, I have 2½ or 3 percent of the stock of Bache.

Mr. **St Germain.** So together, a figure of approximately 5.6 would not be too far off?

Mr. N. B. **Hunt.** I think something like that.

Mr. **St Germain.** You know, I must make an observation here. It is rather peculiar, the two of you sit there and you address each other as Mr. Bunker, Mr. W. H., and you say, "Well, I don't know what he is doing and he doesn't know what I am doing. We act independently." And yet when you look at the transactions, you know, you both happen to go into Bache & Company and controlled Bache, Halsey, Stewart about the same time. Both bought stock to about the same degree. You have both been involved in this silver situation, but I guess maybe you don't talk too often. Maybe you just do it through ESP, I don't know.

Mr. W. H. HUNT. No, that is not the case.

Mr. ST GERMAIN. You do work together, don't you, consult? Aren't you good friends?

Mr. W. H. HUNT. We know each other. We office in the same building. We do eat meals together, lunch I am talking about.

Mr. ST GERMAIN. I am glad to see there is a good family relationship. I was getting a little concerned here that you were getting a little strained in your relationship.

Mr. W. H. HUNT. Yes.

Mr. N. B. HUNT. I think the problem is that we talk too much to each other and not enough to others.

Mr. ST GERMAIN. Gentlemen, you know there is a public perception here, and I, unfortunately, will take issue with some of my colleagues. However, the perception is that the two of you, even though we can't get the numbers here, more or less have become sort of the high priests of the Never-Never Land of the silver futures market, with a lock for a period of time on what seemed to be a sure thing and certainly with an ability to hold large segments of the economy at bay.

You used your substantial economic power to engage in a high-flying brand of international monopoly, and when you and your brokerage houses and financial institutions ran into trouble, the phones started ringing at the Fed for a quick fix, a quick bail-out. Now, whether phone calls came through or the bank or the brokerage houses is immaterial, but Mr. Volcker certainly was right there to receive those calls, the Chairman of the Fed.

Now, frankly, as I said, I disagree with some of my colleagues because I think we have got to see if we can't halt these high-flying games that can only be played by those who have the wherewithal to do so. We must stop reacting after the fact with the fail-safe middle-of-the night bailouts by the banks.

It is my intent within the next few days to introduce legislation that will indeed give the financial institution regulatory authorities the power to set rigid guidelines for the extension of credit on silver futures contracts as well as similar instruments, an end to no-money-down approaches that turn this market into an international crap game.

Senator Proxmire has long before this came about started to work on legislation in this area as well as myself. I intend to work closely with him to make certain that we do have meaningful margin requirements on these transactions, and that there are other regulatory safeguards against the extension of excessive bank credit for speculative activities.

As soon as Senator Proxmire and I have worked out the details of the legislation—and as I say, drafting efforts are continuing—we will immediately begin hearings in the Financial Institutions Subcommittee that I Chair. This will have a priority tag.

Now, gentlemen, there are some, as you well know, that have alleged that you have wrecked the silver market or taken a giant step in this direction. Whether or not that is the case will eventually, hopefully, be determined. However, you gentlemen are to be congratulated in one way because you have indeed served a useful public service, because you will, I feel, be responsible for our at long last addressing some regulations in this area as applicable to financial institutions, and so you will long be remembered not only for your involvement in the silver futures, but indeed probably remembered because as a result of this you may see to it that we give the Federal Reserve Board and the other bank regulatory agencies the necessary authority to step in at the given point in time when it is deemed necessary.

You know, I was very disappointed when Chairman Volcker and John Heimann, the Comptroller, were here the day before yesterday and just threw up their hands "Well, we don't have anything to do with this, we don't have any control or regulatory authority." And so I think the time has come to indeed provide the Fed with the necessary authority in this area.

Gentlemen, the way you operate I will go with W. H. Hunt first: Do you have any controlling positions in any commercial banks, or substantial positions?

Mr. W. H. HUNT. What do you mean by controlling positions?

Mr. ST GERMAIN. By that I mean substantial stock ownership in any commercial banks.

Mr. W. H. HUNT. I own some stock in a bank known as Promenade National Bank, which is a very small neighborhood bank in a shopping center that I developed.

Mr. ST GERMAIN. Could Mr. N. B. Hunt address that? My time is up.

Mr. N. B. HUNT. I own a substantial amount of stock in the First National Bank of Danville, Ill., and that might be classed as control, I don't know. I am not a board member, what not, and also a Mount Greenwood Bank. I am not sure what it is really, what the rest of the name is, which is in the Chicago area.

Mr. ST GERMAIN. I thank the chairman and hope to be able to return to this line of questioning on the second round.

Mr. ROSENTHAL. Congressman Conyers.

Mr. CONYERS. Thank you, Mr. Chairman.

Gentlemen, on March 27, 1980, the silver market tumbled, and the speculative bubble on the silver burst and resulted, in part, because of moves by commodity exchanges in the New York and Chicago area in January to raise the requirement on the amount of money needed to purchase silver futures, and then later to suspend all new purchases. Is that essentially correct?

Mr. W. H. HUNT. I couldn't agree with you more.

Mr. CONYERS. All right. Then on March 29, 1980, 2 days after the collapse, a consortium of big banks approved an $800 million line of credit to yourselves and your associates and companies directly or indirectly under your charge, ostensibly to stem financial collapse of your operations, and the associated businesses connected with you, and also perhaps to stem financial panic. Is that essentially correct?

Mr. W. H. HUNT. I don't believe so, Congressman. You said a few days later?

Mr. CONYERS. That is right.

Mr. W. H. HUNT. I think the loan to Placid, which they are negotiating, has just been approved.

Mr. CONYERS. But essentially these events followed shortly one after the other with the general consequences that I have described.

Mr. W. H. HUNT. Congressman, what events are you talking about now?

Mr. CONYERS. The ones that I just referred to, that 2 days later; that is, after March 27, after the collapse, a consortium of banks approved an $800 million line of credit to stem the financial collapse of those groups and organizations and companies that are associated with you; is that not correct?

Mr. W. H. HUNT. No, I don't believe that is correct, Congressman. The point of the loan to Placid Oil Co. was to enable them to enter into the partnership arrangement, a joint venture, where Placid will be the managing partner, general partner, and I and Bunker Hunt and Lamar Hunt will be limited partners, and it is being put together to refinance silver bullion as well as other investments and other collateral that is going to be contributed thereto.

Mr. CONYERS. Well, now, weren't many of these silver purchases made on lines of credit that were frequently carrying a 1-percent interest rate, and that there were great paper exchanges?

Mr. W. H. HUNT. I haven't found any 1-percent money around, so there must be an error.

Mr. CONYERS. I am talking about lines of credit.

Mr. W. H. HUNT. No, there were no lines of credit on 1 percent.

Mr. CONYERS. This buying or speculation that both of you have been engaged in during the past few years has had a considerable impact on the economy—on credit markets, regulatory agencies, other business firms—and has led to a steep increase in the price of silver, much of it used in commercial processes ranging from hearing aids to film processing and others. It has affected a wide number of companies. One of them is the Chrysler Corp. headquartered in Detroit, Mich.

In Business Week, April 14, 1980, we have the following information, and I quote:

> The liquidity squeeze that silver's collapse is producing abroad is having severe consequences for some U.S. corporations. When Belgium's bank, Banque Bruxelles Lambert, recently sued Chrysler Corporation for $10 million in overdue payments, it cited liquidity problems of its own. The bank also owned 40 percent of NRT Metals, Inc., a member of the New York Commodity Exchange that is going out of business as a result of the boom and bust in silver.
>
> Nearly half of Chrysler's $800 million of outstanding debt is held by foreign banks and just as one of them is the first bank to feel the liquidity squeeze hard enough to sue Chrysler for cash, others may find that they cannot meet all their commitments that they have made for lines of credit to U.S. corporations.

So at a time when Chrysler Corp. is facing enormous difficulties in obtaining credit, we discover that one reason for those difficulties is that its present and potential creditors such as the Belgian bank and maybe others are either calling in their loans or tightening up on future ones as a result of the collapse in silver that has certainly revolved around your actions.

To what degree are you concerned about the calamitous effects that have resulted from your activity in silver, that includes the damage to the credit position of Chrysler, the further damage that has resulted to workers and communities that depend on Chrysler for their livelihood and income?

Mr. W. H. HUNT. Congressman, you referred to my speculation. I was not a speculator. I was an investor, and I really can't respond to your question because I don't agree with the conclusions that you have reached.

Mr. CONYERS. I don't think I have reached any conclusions that are a surprise to any of us who have been following this activity. You don't believe that the Belgian bank has been impaired by the 40-percent ownership that it has in NRT?

Mr. W. H. HUNT. I don't——

Mr. CONYERS. You don't believe that they are in fact suing Chrysler for the millions of dollars that are outstanding because of the tightening of credit?

Mr. W. H. HUNT. I know nothing about that, Congressman. What I was saying is I don't agree with your conclusion that our actions, my actions of buying silver and investing in silver since 1973 made the price of silver go up. As I have already laid out, I think the factor in the market was the regulation and the continual changes instituted by Comex that have made these markets be so wild, become illiquid, and not function.

Mr. CONYERS. In other words, your conduct in the silver future has had nothing to do with the boom-and-burst experience that brings us all here today?

Mr. W. H. HUNT. I don't think that we caused it.

Mr. CONYERS. Well, could you concede that you may have contributed to it in some small way?

Mr. W. H. HUNT. No, I really feel I am a victim.

Mr. CONYERS. Well, now, around here we have been examining this question of credit, and find that it is a very highly scarce commodity. When it is drained off in one area it is denied to other areas—for example, the current inability of farmers, homebuilders, small business to obtain credit. This kind of activity has surfaced in connection with the loan guarantees that involved the Chrysler Corp. last year, in which the question was raised whether $1½ billion in Federal guarantees to Chrysler would siphon off credit that would otherwise be available to other firms. Yet, your organization has been made the beneficiary of a rather large amount of credit to continue in your financial empire.

Do you see your and your family's activities any more deserving of credit than say the Chrysler Corp.?

Mr. W. H. HUNT. Congressman, your statement is incorrect. The loan that is negotiated to Placid, the part of the funds which will be used for the joint venture, are not to create new credit. They are to refinance already existing credit that is there, that will be fully collateralized with assets.

Mr. CONYERS. Let me ask you this. How large is your—a final question, Mr. Chairman——

Mr. W. H. HUNT. And to my knowledge, there are no Belgian banks involved. But as I said, I am not handling the Placid loan, but I think there are no Belgian banks involved, or at least I haven't been told that there are any.

Mr. CONYERS. You are the recipient of large amounts of credit. The Chairman of the Federal Reserve also has been brought in to almost personally help facilitate these arrangements. I am really quite at a loss at the kinds of responses and denials that have been coming from you in connection with what I thought were fundamental assumptions that have been made by this subcommittee before your arrival here.

It seems to me that we are going to have to go back to square one, and document, Mr. Chairman, the activities of the witnesses and then confront them with the fact that there is little likelihood in the kind of testimony that we are receiving that it is going to be forthcoming in terms of information, facts, documents, or any other records. So I would conclude my portion of time by urging that there be a meeting that considers this issue.

Mr. ROSENTHAL. Congressman Levitas.

Mr. LEVITAS. Thank you, Mr. Chairman.

First let me say, Mr. W. H. Hunt, that the questions that you raised in the latter part of your testimony as to matters which you feel this committee and others should inquire about that appear on page 6 are questions which I have already raised with witnesses who have appeared before this committee as well as others which go beyond those questions, and they will not be left unanswered so far as I am concerned.

During the questions that I ask either of you, I want you to understand that when I say you, I mean you personally, yourselves, any nominees or agents acting on your behalf, or any corporations or other entities in which you are a controlling person, and by controlling person I will use the definition that the Securities and Exchange uses of controlling persons for purposes of registration and disclosure.

Now, Mr. W. H. Hunt, do I understand your testimony to be that you and your brother N. B. Hunt act totally independently of each other in making investment decisions with respect to silver and silver contracts?

Mr. W. H. HUNT. Let me answer that in saying that I make all my own decisions as to whether I want to buy silver, sell silver, buy a futures contract, sell a futures contract, and as far as I know my brother Bunker Hunt does also. In fact, there have been cases I have found out where later he was a seller and I was a buyer, and I think we bought from each other.

Mr. LEVITAS. Do you share information about problems in the silver market, or matters relating to investment decisions that you make?

Mr. W. H. HUNT. Well, as I said earlier, we do office in the same building. We do eat lunch together very often. We do contact and discuss things, so, yes, in a general way we do express our feelings between each other.

Mr. LEVITAS. And concerns about the silver market?

Mr. W. H. HUNT. Yes, I have discussed the silver market with him.

Mr. LEVITAS. In some detail?

Mr. W. H. HUNT. Yes, on numerous occasions.

Mr. LEVITAS. Mr. N. B. Hunt, would you adopt that answer or make any changes that you would like to make?

Mr. N. B. HUNT. I think that I can't argue with him on that one. We see each other quite a bit. We talk to each other, and naturally I guess because our contact is close, we have similar views on the market, but Mr. Herbert Hunt sometimes trades, does things differently from me.

Mr. LEVITAS. I want to make it clear I am not suggesting that you always make the same decisions. I am suggesting, however—and if either of you wish to contradict this, this is your opportunity to do so—that you work closely with each other on matters relating to the silver market, and sharing information about its potential and its problems, and that this occurs almost routinely as between yourselves.

Mr. N. B. HUNT. I think, Congressman Levitas, that that is a fair statement, yes.

Mr. LEVITAS. Would you agree, Mr. Hunt, W. H. Hunt?

Mr. W. H. HUNT. Well, it is not a routine schedule or anything of that sort, but I do agree that, yes, we communicate with each other.

Mr. LEVITAS. Yes. About silver?

Mr. W. H. HUNT. Yes.

Mr. LEVITAS. And the market?

Mr. W. H. HUNT. Yes, we discuss all sorts of things.

Mr. LEVITAS. And not just at lunch and not just casually but on other occasions in a more structured——

Mr. W. H. HUNT. No, not really. Basically, we do visit from time to time over the telephone. We office in the same building, same office, so we do have the opportunity to drive by each others office. But as far as having any structured meeting at such and such a time or anything of this sort, that is not the case.

Mr. LEVITAS. Let me just suggest one situation and see how that fits into what you have just described. You know Mr. Robert Wilmuth, I believe. He is, I am told, the president of the Chicago Board of Trade.

Mr. W. H. HUNT. Yes, I know Bob Wilmuth.

Mr. LEVITAS. You know him too?

Mr. N. B. HUNT. Yes, sir, I do know him.

Mr. LEVITAS. I am advised that on October 22, 1979, Mr. W. H. Hunt and Mr. N. B. Hunt were in the office of Mr. Robert Wilmuth, from which office a telephone call was placed to the Commodities Futures Trading Commission discussing certain matters relating to the silver market. Is that correct?

Mr. W. H. HUNT. I can't confirm the date right offhand, but I did meet with Mr. Wilmuth at his request and Mr. Bunker Hunt also was requested to be present, and we were both present and met with Mr. Wilmuth and, with one of their committees. I don't know exactly what the title of the particular committee we met with of the Chicago Board of Trade.

Mr. LEVITAS. And at that meeting there was a phone call made to Commissioner Dunn of the CFTC, in which concerns which either you, both of you and the Chicago Board of Trade had about the silver markets were discussed, and in fact Mr. N. B. Hunt asked for a meeting the next day with Mr. Dunn. Is that correct?

Mr. N. B. HUNT. That is correct, sir. I had never met Mr. Dunn, but I believe, as I recall it, Bob Wilmuth wanted to call him about a particular question that the CFTC had talked to him about, and so when he talked with Mr. Reed Dunn it was on a speaker-phone, there were five or six people in the room and there was a speaker-phone there, and so I asked him, I said I was going to be in the Washington area the next day, could I have the pleasure of coming by and meeting him. And he said that would be fine. And so I did stop by and meet him the next day.

Mr. LEVITAS. Did Mr. Wilmuth indicate to you the reason he wanted both of you to come together rather than separately?

Mr. N. B. HUNT. No, he just said he would like to talk to us both about the market, as I recall.

Mr. W. H. HUNT. I don't know that he gave any particular reason we both were to be there. He did say he wanted to discuss my positions in the Chicago Board of Trade futures market.

Mr. LEVITAS. So far as you know, other than possibly Mr. Wilmuth, were there any other people at that meeting who were persons who were investors in silver, so far as you know?

Mr. W. H. HUNT. Yes. It was discussed. Whether there were people at the meeting who had positions, and I think basically as they went around the room everybody disavowed any positions of any magnitude.

Mr. LEVITAS. And I believe both of you at that meeting stated that all of your positions in silver had been appropriately reported to the CFTC disclosing all silver future positions, and that you stated there were no undisclosed positions through foreign trading companies; is that correct?

Mr. W. H. HUNT. That is correct.

Mr. LEVITAS. That is not only correct that that was said, but is it correct in fact?

Mr. W. H. HUNT. It is correct in fact. I am just thinking to try and remember what the conversations were that took place. I believe that they did bring the matter up as to whether I held any positions under foreign names, and I did inform them that I did not.

Mr. LEVITAS. Mr. N. B. Hunt?

Mr. N. B. HUNT. Yes, that is the same. They wanted to know if there were some foreign corporations, I believe, that were buying contracts, and they wanted to know if we were involved in that, and I assured them we weren't, we were not, that I was not and Herbert spoke for himself.

Mr. LEVITAS. And I want to make sure that my question has been answered. In fact, neither of you had positions in silver through foreign trading companies as of the date that those statements were made to Mr. Wilmuth?

Mr. W. H. HUNT. Congressman, just to make it perfectly clear, under the CFTC reporting conditions, I must report or have reported, which is done for me every day, what my futures positions are, both at Comex and at the Chicago Board of Trade, if you are above a certain number of contracts, which is relatively small. And so that is done for me every day, and it must include any interest in foreign corporations or undisclosed companies and that sort of thing, so it has been reported for my account to the CFTC on a regular basis as required by them, and I do not and have not owned any interest in any undisclosed foreign accounts.

Mr. LEVITAS. Is the same correct for you, Mr.—

Mr. N. B. HUNT. Yes, the very same is correct.

Mr. **Levitas**. Now, do either of you make purchases of silver or silver contracts in the names of others, nominees or other entities in which you are controlling persons? Mr. W. H. Hunt?

Mr. W. H. **Hunt**. If you don't mind, let me visit with counsel. The answer is no.

Mr. **Levitas**. And Mr. N. B. Hunt, is that your——

Mr. N. B. **Hunt**. Could I hear your question again?

Mr. **Levitas**. Yes, sir. Do you make purchases in silver or silver contracts through nominees or through other entities, legal entities, in which you are a controlling person?

Mr. N. B. **Hunt**. I do not. Just so I am not saying something that is misleading, we have—I don't want to be volunteering anything, but I didn't want to misstate the answer. In other words, I don't do anything to be misleading at all, but we do have a company, this Bermuda company that Chairman Rosenthal asked about earlier, and I don't know whether I am the controlling person in it or not. I am a stockholder.

Mr. **Levitas**. What about any trusts in which you are a beneficiary?

Mr. N. B. **Hunt**. None.

Mr. **Levitas**. And the same is true for you, Mr. W. H. Hunt?

Mr. W. H. **Hunt**. Correct.

Mr. **Levitas**. Now let me move just briefly, if I may, to the question of the amount of silver or silver contracts that you owned, say, as of March 28 of this year, approximately, March 30, March 28. How much silver or silver contracts did you own in approximate dollar amounts as of that period? Mr. W. H. Hunt.

Mr. W. H. **Hunt**. I am sorry, I don't have those figures with me, and I would have to compile that. I don't know.

Mr. **Rosenthal**. If the gentleman will yield, that is the key question that we are interested in, because the hearing, the thrust of the hearing, is to find out whether the Hunts generically dominated the silver market in the United States and the rest of the world. That is the key question.

We can't fulfill our supervisory responsibility unless we know whether your alleged control had an impact on the collapse of the silver market. That is the key question.

Did the Hunts generically, all of you, cousins, brothers, sisters, aunts, trusts, Placid, everybody—did you dominate the silver markets in the United States. That is the key question. We must determine that answer.

Mr. **Levitas**. Mr. Chairman, let me take another stab at it.

Mr. **Rosenthal**. Please.

Mr. **Levitas**. In terms of ounces of silver, approximately, as of March 28, 1980, how many ounces of silver did you control either directly or through silver contracts, approximately?

Mr. W. H. **Hunt**. Again, I don't have that figure right at my fingertips, Congressman. I am not trying to be unresponsive, but I think my futures position was approximately 1,500 contracts, something like that, which would represent about 7½ million ounces of silver.

Mr. **Levitas**. How many ounces, please?

Mr. W. H. **Hunt**. Seven and a half million. As to what my actual positions were, I just don't have that figure right at hand.

Mr. **Levitas.** It is readily accessible or available to you, I would imagine?

Mr. W. H. **Hunt.** We can go back and reconstruct it, yes.

Mr. **Levitas.** And would you furnish that to this committee?

Mr. W. H. **Hunt.** Yes, I would be glad to.

Mr. **Levitas.** Now Mr. N. B. Hunt, would you please respond?

Mr. N. B. **Hunt.** I think that I might have around 2,000 contracts. You said March 28?

Mr. **Levitas.** Yes, sir.

Mr. N. B. **Hunt.** I don't know whether they were substantially liquidated. They were all liquidated, so they would have been gone I don't know whether by March 28 or before March 28, but anyway let's say in that time frame. And as to the actual silver, I don't have the figure either, because quite a lot I think would have been liquidated.

Mr. **Levitas.** And how much does 2,000 contracts represent?

Mr. N. B. **Hunt.** That would be 5,000 ounces per contract. It would be 10,000 ounces.

Mr. W. H. **Hunt.** Ten million.

Mr. N. B. **Hunt.** Excuse me, 10 million.

Mr. **Levitas.** Now, as far as the silver itself, that information is readily available to you and you will furnish it to the committee, I take it?

Mr. N. B. **Hunt.** Yes, I will.

Mr. **Levitas.** Now, let me ask you this. Did those amounts which you have just referred to represent the maximum amount of silver that you had at any time from 1973 through 1980? Mr. N. B. Hunt.

Mr. N. B. **Hunt.** I don't know. I suspect—I just don't know. I would have to check the records to be sure.

Mr. **Levitas.** Was it close to the maximum amount?

Mr. N. B. **Hunt.** I would say so, yes.

Mr. **Levitas.** Mr. W. H. Hunt?

Mr. W. H. **Hunt.** I am sure it would be close to my maximum, but again I would have to check that to make sure.

Mr. **Rosenthal.** The time of the gentleman has expired. We will come around again.

Mr. Hunt, W. H., in October of 1979, did you or do you know if any of your colleagues transferred silver to vaults in London through the use of warehouse receipts?

Mr. W. H. **Hunt.** Mr. Chairman, are you saying did I haul silver from this country to London?

Mr. **Rosenthal.** I am asking if you did?

Mr. W. H. **Hunt.** Well, that is what I am trying to ascertain. You are asking me if I took silver from this country to London?

Mr. **Rosenthal.** That is what I am asking you.

Mr. W. H. **Hunt.** The answer is no.

Mr. **Rosenthal.** Did you trade in warehouse receipts that in fact did the same thing?

Mr. W. H. **Hunt.** I don't know about the specific dates you asked on but I did make what are known to me as silver swaps or exchanges where I swapped silver in this country for silver in London?

Mr. **Rosenthal.** Why did you do that?

Mr. W. H. HUNT. This is done all the time. I don't know the particular case you are talking about. But literally I have swapped silver from Comex to the Chicago Board of Trade and vice versa, and from the Chicago Board of Trade——

Mr. ROSENTHAL. I am interested in your transactions involving Mocatta and Sharpe-Pixley specifically. My pronunciation may be somewhat inaccurate.

Mr. W. H. HUNT. I think that I did make an exchange with Sharpe-Pixley which I believe was an EFP, which means an exchange of futures for physicals.

Mr. ROSENTHAL. Was there a physical transfer of silver out of the United States?

Mr. W. H. HUNT. No, there was not.

Mr. ROSENTHAL. Was there a transfer of paper ownership of silver out of the United States?

Mr. W. H. HUNT. Yes, I believe that is correct.

Mr. ROSENTHAL. How much was the silver that was covered in the last answer?

Mr. W. H. HUNT. I am not sure because I am not even sure that it happened at the time you said it did.

Mr. ROSENTHAL. How about you, Mr. Bunker Hunt, did you do the same kind of stuff?

Mr. N. B. HUNT. At times. For instance, yes, at times I would do that.

Mr. ROSENTHAL. We must have from both of you, Mr. Hunts, an accurate response as to how much silver subject to the use of warehouse receipts you transferred out of this country at any time.

Mr. W. H. HUNT. Chairman Rosenthal, I have transferred no silver out of the country.

Mr. ROSENTHAL. You transferred warehouse receipts?

Mr. W. H. HUNT. I have swapped silver or I have actually taken ownerhip of silver overseas. But I have moved no physical silver from this country.

Mr. ROSENTHAL. But silver ownership was transferred from this country to London?

Mr. W. H. HUNT. No, the ownership was transferred from me to somebody else.

Mr. ROSENTHAL. The silver was in vaults in London, isn't that correct?

Mr. W. H. HUNT. Yes. I have acquired silver that is in a vault in London.

Mr. ROSENTHAL. How much silver did you ever have at any one time in a vault in London in dollars?

Mr. W. H. HUNT. I don't know.

Mr. ROSENTHAL. How much silver in dollars did the Hunt enterprises own at any one time?

Mr. W. H. HUNT. I have no idea.

Mr. ROSENTHAL. Would it be between $5 and $10 billion?

Mr. W. H. HUNT. I just don't know.

Mr. ROSENTHAL. Does anybody know?

Mr. W. H. HUNT. I only know what my accountant has done and I don't have the details on either here today. I will be glad to get the figures.

Mr. Rosenthal. Mr. Bunker Hunt, is there any way that anybody in the U.S. Government can find out how much silver the Hunts control, directly or indirectly, cousins, friends, relatives, trusts, corporations, corporate veils, anywhere at all?

Mr. N. B. Hunt. Well, we can reconstruct the figures, I am sure, and let you know.

Mr. Rosenthal. I want you to understand why we are interested in this, because then I think you would participate more freely and more willingly. Nobody is interested in the Hunts as individuals, we are interested in knowing whether under the present regulatory system a small group of individuals can so dominate a market that it impacts severely, in a negative fashion, on the financial and security markets in the United States and, if that is true, even you wouldn't want that to happen, isn't that correct?

Mr. N. B. Hunt. That is correct.

Mr. Rosenthal. In other words, if your silver losses caused the collapse of Bache and some disasters in the stock market, you wouldn't want that to happen?

Mr. N. B. Hunt. We don't owe Bache anything.

Mr. Rosenthal. What we can't understand, and I can tell you I must have 100 telegrams in my office, why is the Chairman of the Federal Reserve Board shepherding your loan or the Placid loan through the 11 banks? Why is he doing that?

Mr. N. B. Hunt. I didn't know that he was shepherding it, the loan for Placid Oil. I think some of the banks consult with the Federal Reserve to see if it is within their guidelines.

Mr. Rosenthal. I can't hear you.

Mr. N. B. Hunt. Some of the banks perhaps talked to the Federal Reserve.

Mr. Rosenthal. He is even familiar with the loan contract. He is giving you debt service collection like a Chrysler worker gets when they get laid off. You are getting free debt collection service from the Chairman of the Federal Reserve. Why?

Mr. N. B. Hunt. I don't know. I never met the man. I never talked to him on the telephone and so I am surprised that he would know any of that.

Mr. Rosenthal. Why have you used International Metals Corp., an offshore corporation, to handle your silver trading?

Mr. W. H. Hunt. As I have said before, International Metals is a corporation that was set up and is jointly owned, half the stock being owned by Saudis, private Saudi citizens, and half of it owned by Hunt trusts, and it is headquartered in Bermuda. It conducts its own business.

Mr. Rosenthal. Why do you use that Bermuda corporation?

Mr. W. H. Hunt. I just said it has ownership of Saudi individuals in it.

Mr. Rosenthal. You did that when you joined forces with the two Saudis, is that right?

Mr. W. H. Hunt. When the Saudis came and approached us and wanted to invest in the silver business, they wanted to buy silver from us and I told them I was not interested in selling any of my silver. They said would we be willing to form a corporation.

Mr. Rosenthal. What did you capitalize that company at, how much capital went into it?

Mr. W. H. HUNT. In the form of stock and subordinated debentures, I believe it was $30 million.

Mr. ROSENTHAL. Last year, 1979, what were the total amount of sales of silver that that company was involved in, sales or purchases?

Mr. W. H. HUNT. I don't have that figure.

Mr. ROSENTHAL. Can you guess?

Mr. W. H. HUNT. I would hate to guess. I would rather get the figure and furnish it to you.

Mr. ROSENTHAL. Here is the problem we have, Mr. Hunt. Chairman Volcker, who is presumably a disinterested party, said that in the period between January and March of 1980, the Hunts controlled two-thirds of the world's known silver. Is that true?

Mr. W. H. HUNT. No, it is not.

Mr. ROSENTHAL. What percentage of the world's known silver did the Hunts control, and I mean all of the Hunts, the corporate Hunts, the cousin Hunts, the brother Hunts, Lamar, who is not here, everybody that could be part of your group? And International Metals. Do you understand the question?

Mr. W. H. HUNT. Yes, I understand the question. I object to the word group, because we all act as individuals.

Mr. ROSENTHAL. Come on now. Look, look.

Mr. W. H. HUNT. If you want to talk about the Hunts as a group, did we own two-thirds of the world's silver, the answer is no.

Mr. ROSENTHAL. Did you own 64 percent?

Mr. W. H. HUNT. The answer is no.

Mr. ROSENTHAL. Sixty-two percent?

Mr. W. H. HUNT. Mr. Chairman, what I am saying is, the two-thirds of the world's silver is a ridiculous figure. We own nowhere near that, even if you gather people up and put the tag on them "group."

Mr. ROSENTHAL. Let's try another system. We are really not getting very far today. In a sense I commend you for that. Inquiry by committee is not necessarily very efficient.

If you had to put a dollar figure on all of the silver that the Hunts control, as of March, the beginning of March 1980, what is the dollar figure?

Mr. W. H. HUNT. I don't know.

Mr. ROSENTHAL. Does anybody know? Can anybody in the family keep a running—Nelson Bunker, do you have any idea?

Mr. N. B. HUNT. No, I don't, Congressman. The market was changing price very fast and I don't know how many ounces it was either.

Mr. ROSENTHAL. Now, do you owe any money? In other words, is there no way for the committee or the Congress to find out how much silver the Hunts controlled, the Hunts as a generic group?

Mr. N. B. HUNT. I can speak for myself and I wouldn't want to speak for anyone else.

Mr. ROSENTHAL. I wouldn't want you to speak for—say that again.

Mr. N. B. HUNT. I will have to get the figure because——

Mr. ROSENTHAL. Could you take a guess?

Mr. N. B. HUNT. I just couldn't guess.

Mr. ROSENTHAL. Did your lawyer tell you to say that?

Mr. **Barry**. I thank you for thinking that Mr. Hunt would say what I would tell him to say.

Mr. N. B. **Hunt**. I didn't hear what he was saying, but anyway, I would have to get the figure. I don't carry those figures around in my head, Chairman Rosenthal.

Mr. **Rosenthal**. Do you know how much either of you owe today to any banks or anybody else because of this silver episode?

Mr. W. H. **Hunt**. I know approximately what my debts are.

Mr. **Rosenthal**. Could you tell us, and to whom they are?

Mr. W. H. **Hunt**. I think that mine would come somewhere around between $4 and $500 million, and they are debts that are all fully secured with collateral.

Mr. **Rosenthal**. What sort of collateral?

Mr. W. H. **Hunt**. Silver.

Mr. **Rosenthal**. Silver bullion?

Mr. W. H. **Hunt**. Silver bullion and other assets, all properties.

Mr. **Rosenthal**. What?

Mr. W. H. **Hunt**. Stocks.

Mr. **Rosenthal**. Who are the principal creditors?

Mr. W. H. **Hunt**. There are the Bache, which you mentioned earlier, I think there is still some loan there, Merrill Lynch, ACLI and Placid.

Mr. **Rosenthal**. If the loan that Volcker is working on doesn't come through, how would that impact on your debts?

Mr. W. H. **Hunt**. Well, as I have already stated, the loan has already been committed to and I don't know it would have—actually the loan is for the restructuring of the debts that I happen to have at this time.

Mr. **Rosenthal**. You say it is for the restructuring of Placid?

Mr. W. H. **Hunt**. That is correct.

Mr. **Rosenthal**. That is what we can't understand.

Mr. W. H. **Hunt**. OK.

Mr. **Rosenthal**. Is this loan for personal deficiencies of Nelson and Herbert, is it for Placid to make new oil explorations? We can't get an honest answer from anybody.

Mr. W. H. **Hunt**. All right, I tried to answer——

Mr. **Rosenthal**. Could you explain it?

Mr. W. H. **Hunt**. I tried to answer it earlier, Congressman. The loan, as I indicated, will be a loan to Placid Oil Co. It is a loan that will be secured, as I understand it, by Placid with collateral consisting of oil and gas properties and things of that sort.

It will also be secured with pledges of assets of mine to Placid Oil Co. Some of the funding used for a partnership joint venture, and into that partnership joint venture go stocks, silver bullion, coal properties, silver forward contracts, cash, T bills, all kinds of assets.

Mr. **Rosenthal**. The loan agreement, does it have a covenant against silver purchases and/or silver speculation?

Mr. W. H. **Hunt**. I don't know.

Mr. **Rosenthal**. Mr. Volcker tells us he is insisting that go into the agreement.

Mr. W. H. **Hunt**. I don't know what the terms of the loan agreement between Placid and the banks are but the partnership arrangement does have a restriction.

Mr. ROSENTHAL. Do you plan to take any more possession of any more silver after that loans is executed?

Mr. W. H. HUNT. I plan on making no more purchases of silver while the partnership is in effect.

Mr. ROSENTHAL. That is for how long?

Mr. W. H. HUNT. That is an indeterminate period.

Mr. ROSENTHAL. Do you folks, Hunts, own less silver today than you did on March 1, 1980?

Mr. W. H. HUNT. I do, yes.

Mr. ROSENTHAL. How much less?

Mr. W. H. HUNT. I don't know.

Mr. ROSENTHAL. Who does?

Mr. W. H. HUNT. It would have to be calculated by my accountant. I will be glad to get that figure and furnish it to you.

Mr. ROSENTHAL. Nelson Bunker Hunt, can you tell us what your current debts are from the silver business?

Mr. N. B. HUNT. No, I don't have those figures with me, Congressman, and I don't have them in my head.

Mr. ROSENTHAL. Can you get it for us?

Mr. N. B. HUNT. Yes.

Mr. ROSENTHAL. Who are the major creditors? Who are your major creditors?

Mr. N. B. HUNT. I think, excuse me—I think they have practically all been paid off, but I would have to check the records and see.

Mr. ROSENTHAL. You don't care whether the loan goes through or not?

Mr. N. B. HUNT. Well, I would like to see the loan go through.

Mr. ROSENTHAL. Why?

Mr. N. B. HUNT. It would enable a restructuring and make it more comfortable.

Mr. ROSENTHAL. Comfortable for who?

Mr. N. B. HUNT. Well, for myself and for Placid and——

Mr. ROSENTHAL. It is incredible how neither of you have any notion. Do you have any notion of how much you are worth, or the Hunts are worth, or anybody?

Mr. N. B. HUNT. No, I don't have any idea. A fellow asked me that once and I said I don't know, but I do know people who know how much they are worth, generally aren't worth much.

Mr. ROSENTHAL. I can't hear you.

Mr. N. B. HUNT. I was just using a cliche that people who know how much they are worth generally aren't worth much.

Mr. ROSENTHAL. You are absolutely right there. Most of us are in that category. Do you have any notion of how much you are worth or any other Hunts?

Mr. N. B. HUNT. No, Congressman, I don't.

Mr. ROSENTHAL. Well, Volcker said you are spending a lot of time with people who are very risky loans. It would seem to me most people when they go to talk about loans, they have to shape up pretty quickly. Wouldn't you say so, Mr. Hunt?

Mr. N. B. HUNT. Well, I always use our financial department to show the figure, but you are correct, Congressman, that, Mr. Chairman, you do have to show the figures at——

Mr. ROSENTHAL. You don't know how much silver you owned in March; you don't know how much silver you own today; you don't

know how much you are worth; you don't know how much you owe. How do you operate? I guess that is why you are successful and we are up here and you are down there.

Mr. N. B. HUNT. I guess my operation can be a little unorthodox, yes, I will agree.

Mr. ROSENTHAL. I know that.

Mr. Jefferies.

Mr. JEFFERIES. No questions.

Mr. ROSENTHAL. Mr. Atkinson.

Mr. ATKINSON. Mr. Hunt, we did a quick calculation on the silver holdings based on what you state you own, you own 7½ million ounces and Bunker Hunt owns 10 million ounces. Together that is 17½ million. At $50 an ounce, $375 million, you, Mr. Hunt, and $500 million with Bunker Hunt. That is $875 million at $50 an ounce, total.

Now it is $10 an ounce, valued at $175 million. So there is a $700 million loss assuming you bought it at $50 and sold it at $10. I am just wondering, that kind of ties together the figures we have been hearing about the $800 million loan. Are these calculations anywhere in line with what your real losses are, $700 million, for the two brothers?

Mr. N. B. HUNT. No, I know the market, when it went to $50, it was just a very liquid situation. I didn't buy any silver, the majority of my silver was bought at $7, $8, $9, $10, $12, in that neighborhood. So, you don't have a loss until you sell something.

Mr. ATKINSON. Paper loss is what I mean. If your paper loss is around $700 million, you get accused of collapsing the silver market. There were 426 million ounces produced, you said in your testimony, back in 1972, in the free world. If you are talking about that kind of figure, as compared against your holdings, it seems hard to understand how you would be controlling the silver market. But you get accused of that.

Mr. N. B. HUNT. I guess.

Mr. ATKINSON. See if we can agree on one thing. According to Mr. Volcker, there are certain legally binding covenants to prevent the money from being used for further speculation on the silver market. In order to clarify the use of the loan money, I would like to ask you a couple of questions, I guess to you, Mr. Bunker Hunt.

You are quoted as having said that you transferred your silver transactions to Europe and the European market does not have the same restraints or disclosure requirements. So is it possible that you could create a similar effect in the silver market in Europe using the money that was loaned to you, since the European market does not require disclosures, to the extent the American market does. Would it not be difficult for the two, the Government Operations Committee here, and the U.S. Government, to trace the loans and enforce the covenants against future speculation?

Mr. W. H. HUNT. If I could, I would like to speak to that. Basically, I do not know the details of the loan between Placid and the banks, but we are entering into a partnership agreement, that being N. B. Hunt, myself, Lamar Hunt and Placid Oil Co., and that partnership agreement does prohibit us from taking positions in commodities by agreement with Placid during the time the partnership exists.

Now, that is true with all cases, except it is also agreed in the agreement that we have the right to take commodity positions that are used in farming and ranching operations and that sort of thing where you are hedging cattle feed or corn that you need, or this sort of thing.

But basically, the agreement between, the partnership agreement between Placid and the other partners prohibits taking positions, new positions in the commodity market.

Mr. **Atkinson**. I appreciate your answer, of course. But the quote was directed to Mr. Nelson Bunker Hunt. That is why I wondered if your view is the same?

Mr. N. B. **Hunt**. Yes, that is correct, we have agreed under this that we would take no future speculative positions, and that is our agreement and that is what we are going to do.

Mr. **Atkinson**. If this loan is approved, would you give full disclosures to this country even though your activities and transactions may be in Europe where the restraints or restrictions are less?

Mr. N. B. **Hunt**. Yes, be glad to do that.

Mr. **Atkinson**. Were you approached by any X-ray companies or electronics firms or camera people who have great use and need for silver, for direct purchase from you of silver?

Mr. W. H. **Hunt**. I have been approached on one or two occasions for the purchase of silver; yes.

Mr. **Atkinson**. Do they offer prices above the market, or the existing price?

Mr. W. H. **Hunt**. No; usually they want a discount.

Mr. **Atkinson**. I thank you both for the responses to the questions. I have no other questions.

Mr. **Rosenthal**. Mr. Deckard.

Mr. **Deckard**. Thank you.

In response to one of the chairman's earlier questions as to whether you intended to make further silver purchases, you indicated no, that you did not, but in your prepared testimony you presented some of the reasons why you considered silver to be a good conservative investment in the first place.

For example, you pointed out that in 1972, free world silver consumption was nearly 426 million ounces while production was barely in excess of 294 million ounces. U.S. demand in 1972 was five times the domestic production, and silver is, of course, an expendable natural resource. Those elements are still here today, and the price of silver today is at what we might consider a more normal level, which would indicate to me that under these conditions, silver is still a pretty good investment.

Why do you not intend to participate further in the silver market?

Mr. W. H. **Hunt**. Mr. Deckard, I think silver is a good investment and continues to be a good investment, but if we are going to have a joint venture with the Placid Oil Co., we have agreed that we will stay out of the silver market while that joint venture functions.

Mr. **Deckard**. Why that agreement, what problem does that cause?

Mr. W. H. HUNT. Well, just a matter of conflict with the joint partnership.

Mr. DECKARD. On the one hand, Placid Oil through its ownership of Gulf Resources is involved in the production of silver; is that correct? It would seem to be an ideal partnership.

Mr. W. H. HUNT. Well, just because somebody owns stock in another corporation, and I have been told Placid does own some stock in Gulf Resources—if you want to use that characterization, I think you can, just like if I owned some stock in Cintex I could say I am in the house building business because I own stock in it, or General Motors, I am in the car building business because I have shares of General Motors.

Mr. DECKARD. As a matter of fact, you are under those conditions. Let me ask you if this is a fair statement: When these new requirements were imposed, the increased margin requirements and the position limitations, you had need for immediate cash to meet your obligations, and you basically had two options, either to liquidate your silver or to put up other assets to meet those obligations. You chose to put up the other assets?

Mr. W. H. HUNT. That is not correct.

Mr. DECKARD. Would you describe then what the circumstances were and why you took the actions you did? I understand in putting up oil and gas leases and other assets——

Mr. W. H. HUNT. When the additional margin requirements were required we had to put up additional cash. This is when the margins were increased, and I put up cash at that time, I did not borrow any additional sums. I had the funds and I put them up.

Mr. DECKARD. Let me ask you this. During 1979 and early 1980, while none of you as individuals may have been aware of the specific amount of your silver holdings, you would have had a general knowledge of the level of those holdings. And, of course, you would have had a general knowledge of the total production and consumption of the United States and of the non-Communist countries.

Although there may have been no intent whatsoever to try to actually effect such a thing, did you ever discuss informally, perhaps even in a joking manner, the possibility of how close you may be to cornering the market, either the United States or the world market in silver?

Mr. W. H. HUNT. Congressman Deckard, at no point was I ever in any position where I cornered anything and so there was no reason for any discussion.

Mr. DECKARD. Did you ever feel you were coming close?

Mr. W. H. HUNT. Congressman Deckard, I never came close to cornering anything, as I have told you.

Mr. DECKARD. Did you ever consider the possibility?

Mr. W. H. HUNT. No.

Mr. DECKARD. I also want to put it in the context of the Hunts, as the chairman says, on a generic basis, and given the total of all of your holdings, how close you may have been to that eventuality and whether it was ever discussed, perhaps not in a serious manner, of trying to actually effectuate it as to how close you were to effecting a corner?

Mr. W. H. HUNT. Congressman, I did not know all the positions that the Hunts had, I only know what my own position was. I was aware that other Hunt members were investing in silver futures contracts.

Mr. DECKARD. You were aware that the Hunts held a substantial amount of silver?

Mr. W. H. HUNT. I was. But I don't think that the figures would show even if compiled and put altogether that the Hunts ever came anywhere near having as you chose to call it, a corner on the silver market or anything of that sort, because we never did.

Mr. DECKARD. Which is not precisely responsive to the question that I have asked.

Mr. W. H. HUNT. I am sorry. If you will rephrase it I will try again.

Mr. DECKARD. Did you ever consider such a possibility or did you ever in even a joking manner talk about that possibility and how close you may be to that position with perhaps any of your other business associates or with any other member of the Hunt family?

Mr. W. H. HUNT. No, I did not.

Mr. DECKARD. I ask the same question of Mr. Nelson Bunker Hunt. Have you ever considered that possibility or discussed it with anyone?

Mr. N. B. HUNT. No, I never did, Congressman. I do not really believe you can corner anything. I was just an investor.

Mr. DECKARD. The thought has never crossed your mind?

Mr. N. B. HUNT. No; no, it didn't.

Mr. DECKARD. When thousands of other people who follow the financial and the commodities markets and so on were speculating on that basis, you never considered it at all?

Mr. N. B. HUNT. Well, I didn't think it was possible or didn't give it any consideration.

Mr. DECKARD. Let me conclude this way. I would like to ask both of you basically in some area what is your opinion as to why prices rose so dramatically in such a short period of time, and why they fell so precipitously in an even shorter period of time.

Mr. W. H. HUNT. If you will look at the chart that was on the back of my statement, I think it describes it best of all. Obviously we had the Iranian hostage seizure, which created some unrest. I know everybody thought they would be out in 2 or 3 weeks, and then it drug on and accelerated, and you will notice the arrow that marks that point on the price chart. Then we had the move up when the Iranian situation got worse. We had the Russian invasion of Afghanistan feed in there. And while it is not marked on this chart, I think it was around January 7 that the Comex started considering or announced that they were going to super margins, as they were called, and so commencing January 7 you had people who didn't want to put up that super margin trying to get out, and that is why you got that 4- or 5-day spike that drove it up approaching $50.

Mr. DECKARD. I wonder if there may be some other factors that might also correlate with those spikes as well. Prior to July 1979, according to your testimony, which both of you have said applies to both of you, you invested substantially in silver futures contracts, rolling them over. After July of 1979, to what extent did you begin to take actual physical possession of the silver, and why?

Mr. W. H. HUNT. I took delivery of some silver near the end of the year because the price had gotten up quite high that if you——

Mr. DECKARD. Pardon me at this point, would that have been sometime in the period of October or November?

Mr. W. H. HUNT. I don't know. I would have to go back and look.

Mr. DECKARD. But at least the last several months——

Mr. W. H. HUNT. Right.

Mr. DECKARD [continuing]. Of the year, which would correspond with the spike you have indicated, the hostage seizure in Iran.

Mr. W. H. HUNT. It would have been along in that timeframe or possibly even a little before. I just do not know, but I do know that I did take delivery of some silver because the price was quite high, and rather than making a taxable event, I felt it was better to own the bullion into the next year.

Mr. DECKARD. That would have represented a tax advantage for you to do that?

Mr. W. H. HUNT. Yes.

Mr. DECKARD. And that was the only purpose. Does that apply equally to Mr. Nelson Bunker Hunt?

Mr. N. B. HUNT. Yes, sir, it does.

Mr. DECKARD. Does this have an effect, psychological or otherwise, particularly with the possibility of squeezing the shorts, that this may have been a principal factor in driving up the price?

Mr. W. H. HUNT. Well, of course many of the Comex actions were announced because of "a threatened squeeze." As I testified before, I did meet with the CBOT and Comex and they asked what my intentions were about futures possessions and this sort of thing, and I basically told them that I was going to roll them forward, et cetera, as I had done in the past, that was my intention, and literally I don't think it was a matter of an unavailability of bullion to be delivered, because there was bullion delivered, and so there was no shortage of bullion. I think probably more than anything we were looking at a cash squeeze that some of the shorts or the trading companies were finding themselves in. In other words, as the price moved up, and they owned actuals with an offsetting short, they were called upon to come up with more funds, and so I think it was a cash squeeze rather than a shortage of silver.

Mr. DECKARD. But doesn't that exert an upward pressure? Isn't that one of the factors involved in the dramatic increase in value?

Mr. W. H. HUNT. You mean does that make the price go up just because there is a cash squeeze?

Mr. DECKARD. Well, it does tend to have that effect, doesn't it?

Mr. W. H. HUNT. No, I think the actual opposite actually happened. I think they changed the rules to be sure they did not have a cash squeeze. They changed the rules to get the prices down.

Mr. DECKARD. On page 3 you have made reference to the purchases that I mentioned just a moment ago. Were those purchases made generally public? Was the public aware that you were entering the market to that extent beyond what you already had?

Mr. W. H. HUNT. What do you mean by "public," Congressman?

Mr. **Deckard**. Was it public knowledge that the Hunts were purchasing silver in these amounts?

Mr. W. H. **Hunt**. Congressman, I didn't take an ad in the paper or call in the press and make a public announcement, but obviously where you are filing with the CFTC and Comex has access to it, it becomes—and your brokers know.

Mr. **Deckard**. It's on the manner of purchase whether it is done directly in your broker's name or through a nominee?

Mr. W. H. **Hunt**. What I was going to say, your brokers know, and so many people know the positions that it becomes pretty well circulated within the trade that you are taking positions or you are selling positions or what have you.

Mr. **Deckard**. Thank you.

Mr. **Rosenthal**. Mr. St Germain.

Mr. **St Germain**. Thank you, Mr. Chairman.

Either one of you. It has been stated that a great deal of movement in the silver market is due to straddling. In other words, what they do is take a loss in one market, and apply those to the gains in another market. Are you familiar with that allegation?

Mr. W. H. **Hunt**. The term "straddling"?

Mr. **St Germain**. Yes.

Mr. W. H. **Hunt**. I have heard the term, yes.

Mr. **St Germain**. Right, and does this indeed at times result in a tax benefit?

Mr. W. H. **Hunt**. Result in what?

Mr. **St Germain**. A tax benefit, to your understanding? Some members of the Ways and Means Committee are concerned about it.

Mr. W. H. **Hunt**. Well, of course all transactions, when they are closed out, you either—you know, you either have a loss or a profit.

Mr. **St Germain**. But you can offset? In this manner you can offset some of the gains?

Mr. W. H. **Hunt**. Yes, I think that is possible.

Mr. **St Germain**. I am just wondering. Maybe that is one of the loopholes that should be closed, in other words, to calm down some of the activity, some of the movement.

Mr. W. H. **Hunt**. I think that people who put on straddles either between markets or within the same market between different delivery months are a good part of the liquidity within the market, and as such they help to make the markets function.

Mr. **St Germain**. Mr. W. H. Hunt, you know at one point you were asked who was hurt, and you said that you were hurt. Well, I would like to tell you, you were not the only one hurt.

Mr. W. H. **Hunt**. Yes.

Mr. **St Germain**. In Rhode Island as well as a few other States we have a lot of people who are employed in the silver manufacturing industry. I met with the silver manufacturers and jewelry manufacturers early this week at an early-morning breakfast, and they state what the rate of unemployment is that has resulted from these extreme fluctuations in price both in gold as well as silver, so there are a lot of people now who are out, you know, collecting unemployment compensation, having trouble feeding their families and educating their children because they no longer have these jobs, so those are some people who were hurt as well.

Mr. W. H. Hunt. Yes.

Mr. St Germain. As a result of this extreme fluctuation in the price.

Mr. W. H. Hunt. Congressman, when you have a free market, there are always people that are affected on both sides.

Mr. St Germain. Yes.

Mr. W. H. Hunt. There are mines being put in. Hardly a day goes by that you don't pick up the paper and so and so is announcing they are opening up a new mine because of higher prices.

Mr. St Germain. I guess what we are trying to determine is whether indeed the silver market was and is a free market or whether indeed it can be manipulated. I think that is one of the purposes of these hearings.

Mr. W. H. Hunt. Yes.

Mr. St Germain. Now let us get to—did I understand correctly a little while ago, Mr. Herbert Hunt and Mr. N. B. Hunt, that you stated that you, Mr. Hunt, on occasions bought some contracts that either of your brothers was selling?

Mr. W. H. Hunt. No, what I stated was that I have at times sold contracts in the market or bought contracts in the market and later found out in just general visits with my brother that he was probably doing the opposite thing on that given day, and I am saying on the market floor that I could have bought his contracts or sold him contracts.

Mr. St Germain. I was impressed, Mr. N. B. Hunt says that most of his he bought between 8 and 12; is that not correct? Did I hear you correctly?

Mr. N. B. Hunt. Well, I was giving a generality of figures.

Mr. St Germain. Averaged out?

Mr. N. B. Hunt. Yes, I think that is probably right.

Mr. St Germain. I was just wondering if maybe you made money on your brother, and that is why—you know, I was also impressed by this. Mr. W. H. Hunt states that he needs or he would borrow approximately $500 million of that $800 million or $1 billion loan that Placid is going to take out and then turn over to the partnership consisting of a general partner and two limited partners.

Mr. W. H. Hunt. I did not state that. I am not borrowing any of that money.

Mr. St Germain. Isn't it going to restructuring loans?

Mr. W. H. Hunt. Placid Oil Co. is the borrower of the funds. A partnership is being set up to which we are contributing, and the we being the limited partners are contributing assets. Placid Oil Co. is contributing cash to that partnership.

Mr. St Germain. Right. Now you are contributing assets, to wit, stocks, holdings, silver, coal.

Mr. W. H. Hunt. Exactly.

Mr. St Germain. OK. Now what are you going to get in return for those assets?

Mr. W. H. Hunt. Half an interest in the partnership, and what I get or receive depends on how the partnership does.

Mr. St Germain. Well, now how about the moneys that—are you telling us that that partnership, that Placid is going to borrow $800 million or thereabouts, that it then goes into a partnership consisting of Placid and the two of you, and that is just a partnership——

Mr. W. H. Hunt. Three.

Mr. St Germain. Lamar. I am sorry.

Mr. W. H. Hunt. Yes.

Mr. St Germain. And that partnership, then—what is going to be the disposal of the $800 million or so? Where are those moneys going to go, that $800 million or so that Placid will be putting into the partnership?

Mr. W. H. Hunt. All right, the partnership is so constructed that Placid will get a preference on the first income, and after they get that preference, then the limited partners receive the next ensuing moneys to repay them for the assets that they put in, and then what is remaining is split on a 50-50 basis.

Mr. St Germain. How are Bache, Halsey and Merrill Lynch and the others going to be repaid? Don't you owe money to Bache, Halsey and Merrill Lynch?

Mr. W. H. Hunt. As I indicated to you I am putting assets into the corporation, pardon me, the partnership, and the partnership will pay off any debts that are involved on those assets as they are put in.

Mr. St Germain. Oh, I mean we are using very technical language, but essentially the moneys are going to be used——

Mr. W. H. Hunt. The partnership will owe no money.

Mr. St Germain. Will owe?

Mr. W. H. Hunt. Will owe no money.

Mr. St Germain. Because Placid owes the money?

Mr. W. H. Hunt. That is correct.

Mr. St Germain. Correct, and Placid invests money in the partnership. You put assets in on which there are outstanding obligations.

Mr. W. H. Hunt. That is correct.

Mr. St Germain. And the partnership will pay off or repay those outstanding obligations. This is what we mean by restructuring.

Mr. W. H. Hunt. That is correct.

Mr. St Germain. All right.

Now, the loan is a 9-year loan to Placid from the banks.

Mr. W. H. Hunt. That is correct.

Mr. St Germain. From what you have stated. What is the length or the term of the partnership?

Mr. W. H. Hunt. It is indeterminate.

Mr. St Germain. Indeterminate. It could be dissolved at any point in time if the partners agree?

Mr. W. H. Hunt. That is correct.

Mr. St Germain. Correct. So that the covenant that you sign in the partnership, and I see members of the Federal Reserve Board here are paying attention, the covenant that you sign in the partnership can be dissolved or the partnership can be dissolved in 6 months, a year, a year and a half from now?

Mr. W. H. Hunt. Pardon me just a second, let me visit with counsel. OK. What I stated is correct. In other words, the partnership could be dissolved sooner, but it is envisioned that the partnership will stay in place as long as the assets that are placed therein have not been disposed of, have not continued to be in existence.

Mr. **St Germain**. So this would allow—what portion of the assets that you will be pledging will be in the form of silver, silver contracts to silver bullion?

Mr. W. H. **Hunt**. I am not pledging anything; I am contributing.

Mr. **St Germain**. The assets that you are contributing, what portion of same?

Mr. W. H. **Hunt**. I don't know that I have those figures right at hand. Let me visit here just a moment. Just a rough calculation. I think we are talking about approximately a little less than half of what is being contributed into the partnership would be in the form of silver.

Mr. **St Germain**. You are talking maybe of $250 million as far as you are concerned in silver at today's price?

Mr. W. H. **Hunt**. In equity of silver, yes.

Mr. **St Germain**. Correct, and then that $250 million in silver, that figure might be inaccurate, but the important part of this question is, that is silver that you owe money on?

Mr. W. H. **Hunt**. That is correct.

Mr. **St Germain**. That is money that is owed to Bache, Halsey and to Merrill Lynch and the other brokerage houses?

Mr. W. H. **Hunt**. Yes.

Mr. **St Germain**. Correct, so those moneys then will be used to repay those loans.

Mr. W. H. **Hunt**. That is correct.

Mr. **St Germain**. And the partnership will then have those assets, and in that manner the partnership can rather than sell the silver, some of which you may have paid $40, $50 for, and the price now is at $10—oh, you did not pay that much?

Mr. W. H. **Hunt**. No, I do not have any $50 silver.

Mr. **St Germain**. So how high did you go?

Mr. W. H. **Hunt**. I think there is possibly a little silver in there in the $32–$33 range, something like that.

Mr. **St Germain**. And so if it were sold now there would be say a $20 loss per ounce?

Mr. W. H. **Hunt**. Correct.

Mr. **St Germain**. On that silver?

Mr. W. H. **Hunt**. Correct.

Mr. **St Germain**. So by getting this loan, this mitigates the loss, because the silver can be held hopefully until the price stabilizes and perhaps increases rather than having to sell it immediately at the low price?

Mr. W. H. **Hunt**. That is a possibility.

Mr. **St Germain**. Now, N. B. Hunt, when you were asked about this partnership—are you contributing assets to this partnership?

Mr. N. B. **Hunt**. Yes, I will.

Mr. **St Germain**. To what degree or what amount?

Mr. N. B. **Hunt**. Approximately the same as my brother.

Mr. **St Germain**. As your brother, but I thought you stated earlier that you did not really need any loans at this time. Are there any loans outstanding on the assets that you will be contributing? In other words, are you putting silver in as well?

Mr. N. B. **Hunt**. Yes, I am putting silver in. There are some loans outstanding, but they are not in default or arrears at all.

Mr. **St Germain**. Correct. Are these loans on your silver purchases from the brokerage houses?

Mr. N. B. **Hunt**. Some of them, yes.

Mr. **St Germain**. But I thought you said that you really did not need this, but did it make you more comfortable? Is that what you said earlier?

Mr. N. B. **Hunt**. Yes.

Mr. **St Germain**. I am happy that you will be made comfortable. You know one of the problems that we see in this $800 million or in excess of same loan is that the President and the Federal Reserve Board have said we want to cool down credit, and golly gee, here is a tremendous amount of money being lent and, you know, there are a lot of small business people who cannot make loans right now because there is a credit squeeze on, and that has been of concern to us.

Mr. **Rosenthal**. I just had one question before I pass to Mr. Conyers, Mr. Hunt. The silver that you put into this partnership, is that being used as collateral against loans for Bache?

Mr. W. H. **Hunt**. Congressman, there was conversation.

Mr. **Rosenthal**. The silver that you are putting into the partnership.

Mr. W. H. **Hunt**. Yes.

Mr. **Rosenthal**. You are putting about $250 million up into the partnership?

Mr. W. H. **Hunt**. Of equity, yes.

Mr. **Rosenthal**. Of equity, and that is going to be used as collateral against the new loan to the partnership, right?

Mr. W. H. **Hunt**. No, that is not correct.

Mr. **Rosenthal**. Is it being used as collateral against any presently existing loan?

Mr. W. H. **Hunt**. Assets that are being contributed do carry some debt with them, and are used as collateral to existing loans.

Mr. **Rosenthal**. That is exactly what I am trying to get at. In other words, the silver that you are putting into the partnership is already pledged as collateral for loans to Bache or to somebody else?

Mr. W. H. **Hunt**. That is correct.

Mr. **Rosenthal**. And the reason the partnership needs this money is not for operating expenses of the partnership, but to satisfy preexisting loans?

Mr. W. H. **Hunt**. That is correct. It will be a restructuring, as I stated earlier. It will be——

Mr. **Rosenthal**. It is a restructuring of your individual loans?

Mr. W. H. **Hunt**. No, a restructuring of the partnership assets.

Mr. **Rosenthal**. What you have done is transferred your loans to the partnership and made it a partnership loan.

Mr. W. H. **Hunt**. OK, let me see if I can clear it up. Basically Placid is the sole borrower for the corporation. They are a corporation. They are pledging assets, oil and gas properties, things of this sort.

Mr. **Rosenthal**. I understand that.

Mr. W. H. **Hunt**. All right. They are contributing into this partnership cash. We are contributing assets, cash, coal properties, all sorts of things.

Mr. ROSENTHAL. I understand that.

Mr. W. H. HUNT. That includes some debt, and the cash that is contributed will be used to pay off the debts.

Mr. ROSENTHAL. Preexisting debts. Why did you form this partnership?

Mr. W. H. HUNT. For the restructuring of these loans.

Mr. ROSENTHAL. It was exclusively for the restructuring of these loans. It was not for new ventures, new opportunities.

Mr. W. H. HUNT. No, it is not to be a partnership that takes on new projects other than the possibility of the coal properties that are being put in. They are nonproducing coal properties.

Mr. ROSENTHAL. And the debts the partnership is assuming are the debts that each of you had personally, not that Placid had, isn't that correct?

Mr. W. H. HUNT. That is correct.

Mr. ROSENTHAL. And that is the kind of loan that the Chairman of the Federal Reserve Board thinks is important for these banks to be making. Do the banks know that you have, for example, your silver already pledged as collateral?

Mr. W. H. HUNT. Yes, they do.

Mr. ROSENTHAL. Mr. Conyers.

Mr. CONYERS. Thank you, Mr. Chairman.

What I would like to find out from Mr. Herbert Hunt is what is it that makes it more important that your group get an $800 million loan than others that are seeking credit on the credit market—small business firms, the construction industry, farmers, industries in trouble, Chrysler Corp. Why do you think this decision was made in your favor?

Mr. W. H. HUNT. I do not know what decision has been made, Congressman Conyers.

Mr. CONYERS. Well, there has been a loan commitment that you reported to us that has already been agreed to, apparently.

Mr. W. H. HUNT. Yes, that's correct. I have been told Placid Co. has concluded their negotiations with a group of banks, and that the funds have been committed to Placid.

Mr. CONYERS. What do you suppose was the basis of need in a credit market that is in very tight supply right now? There is a shortage of credit. We can't get credit in a number of vital areas. A group of big banks are extending you credit, with the blessing of the Federal Reserve Board, why so many others, including Chrysler, have to crawl on their knees and still may be denied credit. Does this strike you as unusual at all?

Mr. W. H. HUNT. Congressman Conyers, your question is not or the assumption is not correct. It is not picking up losses or anything of that sort. It is restructuring the loans that we have existing on present bullion positions.

Mr. CONYERS. My basic question that I would like to try to get a response from you on is in a tight credit market. Why should the Hunt financial empire qualify for credit, a loan of this magnitude, when we have major industries begging and scraping trying to get their credit together? Here is the 10th largest corporation, Chrysler again, trying to get its credit together, being sued by banks that are being adversely impacted by silver. They pay taxes to cities and States all over the country. They pay out wages and salaries of $2.9

billion in the United States alone. They employ 300,000 workers. They purchase $7.9 billion in goods from domestic suppliers. They are very important in the economic picture. Do you have any kinds of comparable sales or purchases or employment or tax payment figures that make the Hunt brothers more worthy of credit than the Chrysler Corp.?

Mr. W. H. HUNT. When you say "you," are you talking about me as an individual, or what?

Mr. CONYERS. You as an individual, your family, the corporate representatives, and the other business agencies that you are connected with.

Mr. W. H. HUNT. If the question is are they as big as Chrysler in numbers of people employed, et cetera, the answer is no.

Mr. CONYERS. What about the economic impact that might occur if the Hunts were not bailed out? What would happen in our economic system if you did not get a loan? I mean, how many people would become unemployed.

Mr. W. H. HUNT. Well, I do not know, Congressman. The point of the loan is the restructuring of already existing loans. It is not creating any additional debt.

Mr. CONYERS. What are the consequences, though, if your loan, a sizable one, is not completed and consummated? What would be the economic impact across the country as you see it?

Mr. W. H. HUNT. Well, again, Congressman, the thing I am trying to get across is that it's not creating a new loan. It's merely a matter of restructuring the loan, so it's not creating any additional borrowings in the total.

Mr. CONYERS. In other words, are you able to compare your situation with the Chrysler Corp. in terms of economic impact?

Mr. W. H. HUNT. Congressman, this is a totally different situation from Chrysler. This is a loan that is collateralized with producing assets making money, that is, good collateral, the banks are assured of getting their funds back, and it's not——

Mr. CONYERS. Nobody can lose in this?

Mr. W. H. HUNT. It is not creating additional borrowing. It is a matter of restructuring debt that is already out there.

Mr. CONYERS. You mean that the Federal Reserve Chairman didn't help arrange a loan of moneys for you that created new money?

Mr. W. H. HUNT. I have no idea what the Federal Reserve Chairman's part in this is other than I know that the banks on a loan of this size, I am told, clear to make sure they are following the guidelines.

Mr. CONYERS. Well, let me ask Mr. Bunker Hunt the question about tax straddling, commodity tax straddling. Are you aware of it?

Mr. N. B. HUNT. I didn't mention it. Someone else may have mentioned it.

Mr. CONYERS. Have you ever heard of the phrase, "commodity tax straddling"? It's a new one that came to my attention rather recently as a result of this hearing and I assumed that you were familiar with the term.

Mr. N. B. HUNT. I have heard the term, yes, sir.

Mr. CONYERS. Do you know what it means?

Mr. N. B. Hunt. Well, I think so, yes.

Mr. Conyers. All right, then, just to make sure that we both understand, could you describe what it means in terms of your understanding?

Mr. N. B. Hunt. Well, it's a risk-taking transaction where you take a long, a long in one month and a short in another, and at times it can work to a tax advantage.

Mr. Conyers. Right.

Mr. N. B. Hunt. Depending on whether the market goes up or down.

Mr. Conyers. There can be gains and losses simultaneously?

Mr. N. B. Hunt. Yes.

Mr. Conyers. That would be used to avoid or defer taxes; is that essentially the same thing that you were saying?

Mr. N. B. Hunt. Well, I am not an expert on taxes, sir.

Mr. Conyers. I see.

Mr. N. B. Hunt. But I think it has—there are sometimes tax losses, sometimes tax gains.

Mr. Conyers. Have you ever indulged in this investment technique?

Mr. N. B. Hunt. I think I had a few straddles last year, yes, a few spreads.

Mr. Conyers. Can I ask Mr. Herbert Hunt, are you familiar with this technique that we are discussing?

Mr. W. H. Hunt. In a general way, yes.

Mr. Conyers. All right, have you or your companies or your business representatives ever engaged in this technique?

Mr. W. H. Hunt. I as an individual, I have——

Mr. Conyers. I didn't ask that. I said you or your companies or your business representatives, have they ever engaged in that technique, as well as yourselves?

Mr. W. H. Hunt. Well, I don't know——

Mr. Conyers. You don't know what they did?

Mr. W. H. Hunt. I didn't know what they did. I know that I have utilized tax spreads at times or straddles or whatever you want to call them, where you put on a position for delivery in one month or a sale in one month and delivery in another.

Mr. Conyers. In other words, you have engaged in this technique?

Mr. W. H. Hunt. Yes.

Mr. Conyers. That is what I am trying to find out.

Mr. W. H. Hunt. Yes.

Mr. Conyers. OK. It is fairly commonplace in your business, is it not—not just for you but for others—it is a fairly well-known technique?

Mr. W. H. Hunt. Straddles are used extensively, as I have said earlier, in the commodity market, and they are used for numerous different reasons.

Mr. Conyers. They result in the U.S. Government collecting less taxes in the long and the short run, I would suppose; isn't that essentially the impact of that technique?

Mr. W. H. Hunt. No, that is not the impact.

Mr. Conyers. I see. What is it, in your judgment, or from your point of view?

Mr. W. H. HUNT. Well, the impact is that they are positions that are put on that furnish liquidity to the market and they can result, the risks in the position because the values change from month to month on a given commodity and they can result in a loss or a gain and sometimes those losses or gains fall in one given year and the offsetting loss or gain falls in the next year. So they can delay a tax event but they cannot put it off in the long term or result in less taxes in the long term.

Mr. CONYERS. I still have yet to find out why the credit priorities are so warped in our financial world, so that major income-producing, job-generating companies such as Chrysler go begging for loans, while others like the Hunts, readily obtain credit, even if it is arranged to cover their own speculative ventures and the risks they should shoulder themselves. I think this should be a very important part of our concern.

Mr. ROSENTHAL. Mr. Levitas.

Mr. LEVITAS. Thank you, Mr. Chairman.

Let me summarize, preface my questions with some of the things I think I have learned this morning. The first is that whether or not you operate as investors or speculators in this silver market, each of you have played a significant role in the silver market, either individually or in some way jointly, collectively or otherwise, sharing information, making common approaches to regulatory bodies as well as to the exchanges.

Evidence of the fact that there is a commonality of interest and purpose is the very fact that when it came to doing something about cleaning up the mess after the market crash, we see that both of you, or together with another brother, or part of a joint venture partnership, which will be the ultimate beneficiary of an $800 million-plus loan, so, wherever you started on this certainly at this point you are in it together, each contributing partners to this partnership, that will be the beneficiary of the loan being made by Placid, and Placid in turn being owned by a trust of which each of you and your brother, the other brother, are the principal beneficiaries.

Now, having said that, to begin with I would like to find out, Mr. Bunker Hunt, is there more than one loan that is either being negotiated or has been made relative to your dealings in silver since March 28?

Mr. N. B. HUNT. Only one loan that I know anything about.

Mr. LEVITAS. Now, Mr. W. H. Hunt, when you went to Boca Raton and met with the bankers down there and talked about a loan, was that a loan different from the one which has been made to Placid?

Mr. W. H. HUNT. That is correct.

Mr. LEVITAS. What was the result of your inquiries or efforts in Boca Raton with respect to securing another loan, a different loan?

Mr. W. H. HUNT. Well, at the time I was at Boca Raton we were talking to a group of bankers who happened to be there on a convention and I was talking about making a loan myself as an individual.

Mr. LEVITAS. And that didn't go through?

Mr. W. H. HUNT. There was no interest in it.

Mr. LEVITAS. That loan was not made?

Mr. W. H. HUNT. That loan was not made.

Mr. LEVITAS. So, as far as you know, the only loan involving your dealings in silver relating thereto, since March 28, is the loan which was made to Placid and which will be contributed to this partnership you described?

Mr. W. H. HUNT. Well, the funds will be attributed to this partnership.

Mr. LEVITAS. That is the only one you are aware of?

Mr. W. H. HUNT. Yes.

Mr. LEVITAS. Now, the Placid loan, Mr. N. B. Hunt, why did you need to restructure your debt? What was the need for restructuring your debt? You said, you told Mr. Rosenthal in answer to a question that your outstanding debt was current, not in default, so why did you need to restructure?

Mr. N. B. HUNT. There were some banks that wanted to be paid off and the loans were coming due.

Mr. LEVITAS. And those banks are being paid off as a result of this restructuring?

Mr. W. H. HUNT. Yes, that is right.

Mr. LEVITAS. And by restructuring, we have been using that term all morning long, and Mr. Volcker used it the other day, what you are in effect doing is paying off some creditors, extending or delaying payments on others. Is that what you are referring to as far as restructuring?

Mr. W. H. HUNT. No, it is a matter of paying one group of banks, one group of banks off, and borrowing from one group of banks and paying the second group off.

Mr. LEVITAS. If you hadn't borrowed from the second group to pay off the first group, the first group would have taken some action; is that correct?

Mr. W. H. HUNT. When the loan comes due, yes.

Mr. LEVITAS. Is the interest that is being paid to this consortium of banks on the new loan greater or less than the interest that was paid on their structured loans?

Mr. W. H. HUNT. Approximately the same, I believe.

Mr. LEVITAS. What is that interest rate?

Mr. W. H. HUNT. I am not positive of this, but prime rate plus 1½ or 2 percent, in that neighborhood.

Mr. LEVITAS. It would be in the neighborhood of 20 percent plus for the loan being made to Placid?

Mr. W. H. HUNT. Yes, sir.

Mr. LEVITAS. Is that correct?

Mr. W. H. HUNT. I believe that is correct, yes.

Mr. LEVITAS. And that is approximately the same as the interest that was accruing on the loans that are being paid off?

Mr. W. H. HUNT. I think approximately so.

Mr. LEVITAS. Why did those banks that you are paying off want to get out of it? Is there any reason for them to feel less secure than the banks who are making the new loan?

Mr. N. B. HUNT. Well, I think there is insecurity among some of them about the silver market, and they are collateralized with silver. This other loan will be collateralized with oil, gas, and other properties.

Mr. LEVITAS. Now, speaking of the silver, it is my understanding that as part of this new restructured loan arrangement and formation of this partnership it is anticipated that the partners will be selling their silver holdings over the next several months. Is that your understanding, Mr. N. B. Hunt?

Mr. N. B. HUNT. Over the next several years, I believe. That is indeterminate, depends on the market. But, again, 3 or 4 years, something like that. It's a 9-year loan.

Mr. LEVITAS. But it is contemplated there will be a liquidation of those silver holdings?

Mr. N. B. HUNT. Yes, over a period of time, yes.

Mr. LEVITAS. Is it anticipated that that liquidation will occur on the open market or through negotiated sales or both?

Mr. N. B. HUNT. Probably. That is up to the partnership. Of course, the general partner is Placid Oil Co., but I would think probably largely negotiated.

Mr. LEVITAS. Largely negotiated?

Mr. N. B. HUNT. Yes.

Mr. LEVITAS. With independent third parties, or could it be liquidated between members of this partnership?

Mr. N. B. HUNT. Well, I don't know. There is speculation at this point in time, but it will be up to the market conditions whether the silver market is allowed to come back and operate viably, there is a silver market, and so forth.

Mr. LEVITAS. Were any debts incurred for which the restructuring is to take place related exclusively to silver transactions?

Mr. N. B. HUNT. Yes, I think so.

Mr. LEVITAS. Now, the New York Times in a report stated, Mr. W. H. Hunt, that you described your liabilities at Boca Raton as totaling $1.7 billion, some of which was backed by collateral. Is that an accurate report?

Mr. W. H. HUNT. It was at that time. It no longer is.

Mr. LEVITAS. Now, what were the actual liabilities related to silver that each of you had as of March 28, 1980, including obligations to brokerage firms, banks, including foreign banks, and brokers, such as Engelhard Metals, and loans from your own company, Placid?

Mr. W. H. HUNT. I am sorry, I do not have those figures with me. It would take an accountant some time to put them together.

Mr. LEVITAS. Do you have that information, Mr. N. B. Hunt?

Mr. N. B. HUNT. No, sir, I don't.

Mr. LEVITAS. Will you make that information available to this committee?

Mr. W. H. HUNT. Would you mind repeating exactly what it is you want again?

Mr. LEVITAS. As of March 28, 1980, the actual silver-related liabilities that you had, and remember my definition of the word to you earlier on, to brokerage firms, banks, including foreign banks, and brokers, corporations, such as Engelhard Metals, as well as loans from your own companies.

Mr. W. H. HUNT. Fine.

[The information referred to begins on p. 338.]

Mr. ROSENTHAL. Time of the gentleman has expired.

Mr. **Levitas**. I have one thing I would like to just clarify for the record, so there won't be any misunderstanding about it.

I had earlier asked for certain information to be furnished to the committee which the witnesses in the spirit of cooperation they have displayed have agreed to, and I did not want there to be any misunderstanding about what that is. I have been trying to quantify your silver holdings so that we can assess the allegations made by Mr. Volcker that there was an effort, to use the common word, to corner the market, which you have here denied.

What I would like to find out, as of three dates, December 1, 1980, or December 7——

Mr. **Rosenthal**. 1979.

Mr. **Levitas**. 1979, I'm sorry. December 1 or 7, whichever date you select, 1979, January 1, 1980, and March 28, 1980, the quantity of silver involved in vault receipts, both here in this country and abroad, the quantity of silver covered by future contracts or forward contracts deliverable after January 8, 1980, the extent of financial interests in companies which mine or hold silver including, if that information is available, and I am satisfied it is, the amount of silver involved. For example, I understand Gulf Resources is one of the companies involved—silver bullion and coins in storage, which is not covered by vault receipts. Just illustrate that which may be held in the Cayman Islands and Bermuda, all silver being held by banks, brokerage firms, or other financial institutions as collateral for loans, with respect to each of you, as I have previously defined that term—as well as Placid Oil, International Metals. That, I think, spells out—I will be happy to furnish a letter in writing so that there can be no misunderstanding so you will have that information, and will you be able to make that information available to us?

Mr. **Goldburg**. I was going to ask, Mr. Congressman, through the chairman, if I might add, if you would make such a request in writing, we will produce it, sir.

Mr. **Rosenthal**. It will be delivered to you in writing.

Mr. **Goldburg**. In a reasonable period.

Mr. **Rosenthal**. I think we told counsel we would let you go by 1 o'clock. Presumably you have to be in the Senate by 2 o'clock.

Let me ask for the record, I didn't understand it, the loan to Placid from the consortium of banks, is it $800, a billion, a billion one, how much is it?

Mr. W. H. **Hunt**. Counsel tells me that it is currently proposed to be approximately $1 billion but all of the money does not go into the partnership.

Mr. **Rosenthal**. I thought all of the money was going to Placid and Placid was putting it in the partnership.

Mr. W. H. **Hunt**. Placid has operations of its own and it's——

Mr. **Rosenthal**. Some of the money is going to Placid and some isn't?

Mr. W. H. **Hunt**. I don't know. You would have to ask Placid, but it's my understanding that they are making a loan and they are taking a commitment to put *x* dollars into the partnership, with *x* to be defined when the assets and all are contributed——

Mr. **Rosenthal**. I still don't understand it. What is going to happen to the proceeds of the billion dollars? Who does it go to, how much to whom?

Mr. W. H. **Hunt**. All right. As I indicate, testified to earlier, there is a preference that goes to Placid first, and that preference is 25 percent.

Mr. **Rosenthal**. The lawyer behind you is shaking his head. Maybe you had better have a quick consultation. Remember, you are under oath; he is not.

Mr. W. H. **Hunt**. You are talking about the proceeds of the loan?

Mr. **Rosenthal**. That is exactly what I was talking about. Tell us what happens to the billion dollars.

Mr. W. H. **Hunt**. It's up to Placid, but they will——

Mr. **Rosenthal**. It all goes to Placid, right?

Mr. W. H. **Hunt**. That is correct.

Mr. **Rosenthal**. Have you, Mr. W. H. Hunt, since March 28 sold off any physical silver?

Mr. W. H. **Hunt**. March 28?

Mr. **Rosenthal**. Yes.

Mr. W. H. **Hunt**. I would have to go back and check. I think so.

Mr. **Rosenthal**. Can you tell us how much?

Mr. W. H. **Hunt**. I don't know.

Mr. **Rosenthal**. Can you, Mr. Hunt, N. B.?

Mr. N. B. **Hunt**. I don't have any knowledge of any being sold, but I would have to check the record.

Mr. **Rosenthal**. Some people said this loan is being made in a convoluted fashion so both of you can hold on to the silver you had rather than being forced to sell it. How would you comment on that?

Mr. N. B. **Hunt**. Well, I think it's partially being made to help that there will be orderly sales when we do.

Mr. **Rosenthal**. Say that again?

Mr. N. B. **Hunt**. So there will be orderly sales when it's desirable to sell.

Mr. **Rosenthal**. The point I am trying to make, if you folks dominated the market by physical ownership, you still essentially after all the debacle own essentially the same amount of silver.

Mr. W. H. **Hunt**. No, that is not true.

Mr. **Rosenthal**. How much less do you own?

Mr. W. H. **Hunt**. I have told you I don't know; we would have——

Mr. **Rosenthal**. If you don't know, how can we intelligently approach this problem? Who does know, nobody? Can you furnish for the record, and also put it in writing, exactly how much silver you have sold since March 28?

Mr. W. H. **Hunt**. Fine.

Mr. **Rosenthal**. The way it looks to some of us is the Federal Reserve is cooperating or shepherding a loan for $1 billion so that you and your colleagues won't have to sell any silver in a depressed market. That is the way it looks.

Mr. Deckard.

Mr. **Deckard**. Thank you, Mr. Chairman.

The witnesses have been here a long time, they have been very cooperative, and I will be very brief. I would like to clarify for my own benefit some of the responses that were given both to Mr. Levitas and to the chairman.

The first is: Did you say that the first loan was collateralized with silver and the second loan was collateralized with other assets, or was it the reverse?

Mr. W. H. HUNT. I am sorry, I am not familiar with which loans you are talking about when you say first and second.

Mr. DECKARD. Well, the original debt of Placid was somewhere in the area of $1 billion, and then the second loan that was taken out to retire the first debt, which loan was collateralized by what assets?

Mr. W. H. HUNT. There is confusion. Placid Oil Co. is receiving a loan, and that loan will be collateralized with oil and gas properties and its assets.

Mr. DECKARD. Not with silver?

Mr. W. H. HUNT. As well as—not with silver—then funds are.

Mr. DECKARD. Doesn't that mean then that you are retaining silver holdings? The original loan, the second loan was collateralized with silver. Therefore, you are relieved of the obligation against silver that you once had; is that correct?

Mr. W. H. HUNT. Congressman Deckard, what happens is that the existing silver positions along with these other assets of coal, stock, et cetera, are contributed to the partnership along with the debts that go with them from Nelson Bunker Hunt, W. H. Hunt, and Lamar Hunt, and then on the other side, Placid puts in cash to equal, to form the partnership, and that cash is used to pay off the debts that presently exist with the brokerage houses that are collateralized with silver, with stocks, and things like this.

Mr. ROSENTHAL. That is, Placid gets the money and pays off the individual debts? It pays off the partnership debts because the assets of the individuals are transferred to the partnership?

Mr. W. H. HUNT. That is correct.

Mr. ROSENTHAL. Mr. St Germain.

Mr. ST GERMAIN. Thank you, Mr. Chairman.

Is Lamar Hunt also contributing assets to the partnership?

Mr. W. H. HUNT. Yes, sir.

Mr. ST GERMAIN. In what amount, approximately?

Mr. W. H. HUNT. That hasn't been determined, but it would be relatively small.

Mr. ST GERMAIN. Among the assets he is contributing, would there be silver involved as well?

Mr. W. H. HUNT. Silver bullion? No.

Mr. ST GERMAIN. Or contracts?

Mr. W. H. HUNT. There are some futures contracts, possibly.

Mr. ST GERMAIN. And are there debts owing on those that will be repaid with moneys from the partnership?

Mr. W. H. HUNT. I don't believe so.

Mr. ST GERMAIN. Mr. Herbert Hunt, if the loans to Placid were not agreed to and, therefore, the partnership would not come about, would you be in a position economically and financially to nonetheless repay the loans outstanding against the assets that you will be pledging?

Mr. W. H. HUNT. Over a period of time, yes.

Mr. **Deckard**. Would the gentleman permit me to reclaim my time?

Mr. **Rosenthal**. You told me you only had one question. I assumed when you had three I could go to St Germain.

Mr. **Deckard**. That is the chairman's prerogative.

Mr. **Rosenthal**. Finish up, and we will come back to you.

Mr. **St Germain**. Mr. N. B. Hunt, the same question to you. I think you said you would be more comfortable with the Placid loan in the partnership, you could repay, indeed repay the amounts outstanding without the partnership agreement; is that correct?

Mr. N. B. **Hunt**. I think it could be repaid over a period of time.

Mr. **St Germain**. Now, Mr. N. B. Hunt, you do indeed have loans from banks that will be repaid?

Mr. N. B. **Hunt**. Yes, sir.

Mr. **St Germain**. According to what you testified to earlier, are some of these loans secured by silver or silver contracts, silver bullion?

Mr. N. B. **Hunt**. Silver and stocks and so forth.

Mr. **St Germain**. Well, I am mainly concerned about silver. There are some secured——

Mr. N. B. **Hunt**. There are some.

Mr. **St Germain**. Do you know which banks you owe the money to?

Mr. N. B. **Hunt**. I don't have a list here with me.

Mr. **St Germain**. Are any of the banks to which you owe the money participants in the new consortium that will be lending money to Placid?

Mr. N. B. **Hunt**. Some of them, perhaps, but mostly no.

Mr. **St Germain**. Would you provide for the record—I will ask staff to make sure I get this—the only banks I am interested in, N. B. Hunt, that you owe money to are those where the loans were made for silver purchases. Would you provide that for the record for us?

Mr. **Goldburg**. May I interrupt, Mr. Congressman. You are inquiring of information of banks that have made loans to Mr. N. B. Hunt?

Mr. **St Germain**. Correct.

Mr. **Goldburg**. That were secured by silver?

Mr. **St Germain**. Correct.

Mr. **Goldburg**. Not for the purpose of purchasing silver?

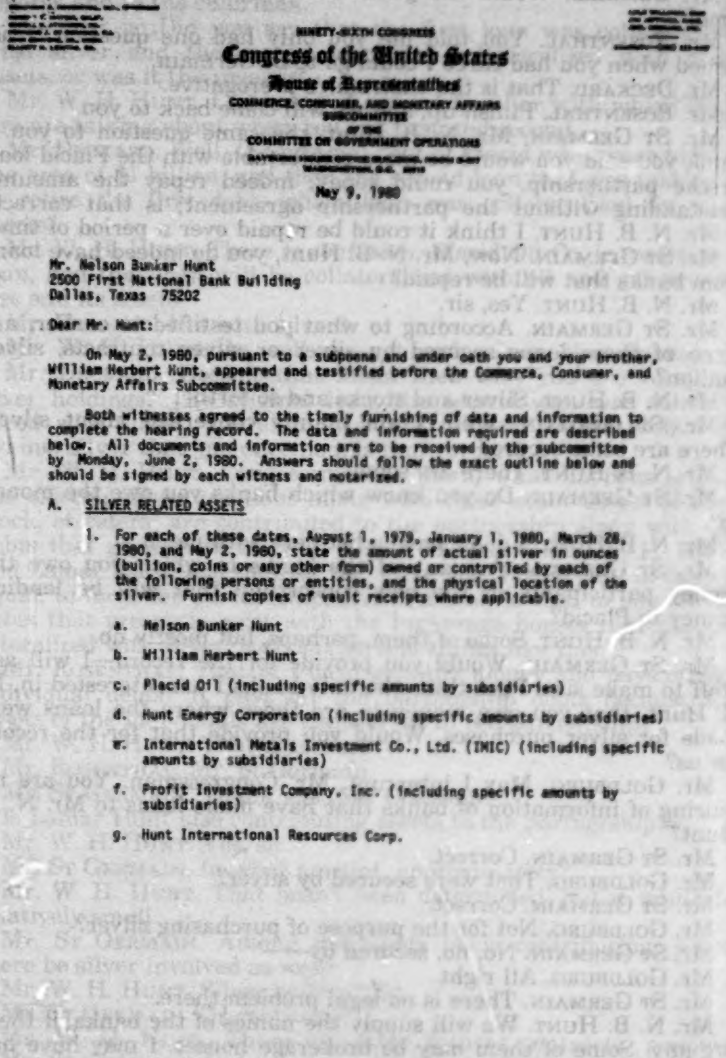
Mr. **St Germain**. No, no, secured by——

Mr. **Goldburg**. All right.

Mr. **St Germain**. There is no legal problem there.

Mr. N. B. **Hunt**. We will supply the names of the banks, if there are any. Some of them may be brokerage houses. I may have had the two confused.

[The information follows:]



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NINETY-SIXTH CONGRESS

Congress of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
[illegible]

May 9, 1980

Mr. Nelson Bunker Hunt
2500 First National Bank Building
Dallas, Texas 75202

Dear Mr. Hunt:

On May 2, 1980, pursuant to a subpoena and under oath you and your brother, William Herbert Hunt, appeared and testified before the Commerce, Consumer, and Monetary Affairs Subcommittee.

Both witnesses agreed to the timely furnishing of data and information to complete the hearing record. The data and information required are described below. All documents and information are to be received by the subcommittee by Monday, June 2, 1980. Answers should follow the exact outline below and should be signed by each witness and notarized.

A. SILVER RELATED ASSETS

1. For each of these dates, August 1, 1979, January 1, 1980, March 28, 1980, and May 2, 1980, state the amount of actual silver in ounces (bullion, coins or any other form) owned or controlled by each of the following persons or entities, and the physical location of the silver. Furnish copies of vault receipts where applicable.

   a. Nelson Bunker Hunt

   b. William Herbert Hunt

   c. Placid Oil (including specific amounts by subsidiaries)

   d. Hunt Energy Corporation (including specific amounts by subsidiaries)

   e. International Metals Investment Co., Ltd. (IMIC) (including specific amounts by subsidiaries)

   f. Profit Investment Company, Inc. (including specific amounts by subsidiaries)

   g. Hunt International Resources Corp.

h. all other trusts, partnerships, associations, private or SEC-unregistered corporations, or other unincorporated organizations or legal entities in which N. B. Hunt, and/or W. H. Hunt, has or receives a direct or indirect beneficial interest or of which N. B. Hunt and/or W. H. Hunt, is an owner, partner, or financial participant.

2. For the same four dates, state the number of silver futures contracts by position, amount, month, and exchange (include overseas transactions), for the persons or entities listed in 1, a-h, above.

3. For the same four dates, set forth outstanding forward contracts, including amounts and form of silver, and parties to the agreement, for the persons and entities listed in 1, a-h, above. Furnish supporting documents or copies.

4. For the same four dates, set forth any other contractual rights to purchase or receive silver, with amounts, for the persons and entities listed in 1, a-h, above.

5. For the same four dates, set forth the nature and extent of the financial interest or investment, including purchase options, in any brokerage firm or any corporation that owns or controls a brokerage firm and the amount of such interests (specify the number of shares in the case of equity investments and, in the case of debt investments, dollar amount and conversion rights, if any) for the persons and entities listed in 1, a-h, above.

6. For the same four dates, set forth the nature and extent of the financial interest or investment, including purchase options, and the amount of such interests (specify the number of shares in the case of equity investments and, in the case of debt investments, dollar amount and conversion rights, if any) in each of the following for persons or entities in 1, a-d, g-h, above.

   i. Gulf Resources and Chemical Corporation
   ii. First Chicago Corp.
   iii. Goldfield Corp.
   iv. Global Marine Inc.
   v. Sunshine Mining Co.
   vi. Louisiana Land and Exploration Co.
   vii. IMIC
   viii. Profit Investment Co.

7. Set forth your relationship, if any, with the following:

   ix. National Commodity and Barter Association

   x. Multi-Projects Ltd.

   xi. American Law Association

B. SILVER RELATED LIABILITIES

For each of the dates listed in A, above, set forth the liabilities, debts, and contractual obligations for the persons and entities in 1, a-h, above in each of the following categories (Note location of creditor located or incorporated abroad).

1. brokerage firms or brokerage firm affiliates, by name, date incurred, amount of the obligation and types and amounts of collateral, if any,

2. banks, by name, amount of obligation and types and amounts of collateral, if any,

3. other persons, corporations, or entities to whom more than $10 million was owed at any one time during 1979 or 1980 to date (including Hunt trusts, corporations, subsidiaries, relatives, etc.), and types and amounts of collateral, if any.

C. BANK LOANS AND LINES OF CREDIT

1. a. List by amount and creditor the liabilities discussed at Boca Raton, Florida, March 30, 1980, reported to have totaled approximately $1.7 billion.

   b. List by name and bank affiliation each bank officer with whom these liabilities were discussed.

2. Describe the partnership between Placid Oil and the Hunt brothers, including the following:

   a. State all terms, conditions, and convenants of the agreement. Furnish supporting documents.

   b. A description and the value or amount of all assets and liabilities transferred or to be transferred into the partnership, by each general partner and each limited partner. Furnish supporting documents.

   c. What restrictions, covenants or agreements are there on assets which Placid Oil contributes to the partnership? Furnish supporting documents.

3. a. Name each bank or other creditor participating in the loans and/or lines of credit extended to Placid Oil since March 28, 1980, the amount contributed to date by each, and the maximum amount each has agreed to make available to Placid Oil.

   b. State the terms, conditions, and convenants of these loans and/or lines of credit. Furnish supporting documents.

Sincerely,

Benjamin S. Rosenthal
Chairman

BSR:tb

cc: Roger Goldburg, Esquire
Shank, Irwin, Conant, Williamson
& Grevelle
3100 First National Bank Building
Dallas, Texas 75202

Paul L. Perito, Esquire
Perito, Duerk, Carlson and Pinco
1140 Connecticut Avenue, N.W.
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SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE
ATTORNEYS AT LAW
[illegible] FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS [illegible]
[illegible]

[illegible]
WASHINGTON, D.C. [illegible]
[illegible]

June 4, 1980

Hon. Benjamin S. Rosenthal
Chairman
Commerce, Consumer & Monetary Affairs
Rayburn House Office Building
Room B-377
Washington, D.C. 20515

Dear Mr. Chairman:

This letter is written in response to your letters of May 9, 1980, addressed to our clients, Nelson Bunker Hunt and William Herbert Hunt, in which the Sub-Committee on Commerce, Consumer & Monetary Affairs of the House Government Operations Committee (the "Sub-Committee") requested certain additional information in connection with its inquiry into the operations of the silver futures market.

Our clients have endeavored to respond as fully as possible to the Sub-Committee's requests. It should be noted that much of the information and documents provided have been obtained from Hunt Energy Corporation. For your information, Hunt Energy Corporation is, inter alia, a comprehensive service entity that performs services for many corporate entities and individuals, including some of the entities and individuals from whom the Sub-Committee has requested information. Because much of the information was obtained from Hunt Energy Corporation, our clients cannot insure its accuracy, especially with respect to information pertaining to parties other than themselves.

No responses have been provided for Hunt Energy Corporation. We have been informed that Hunt Energy Corporation has no assets, investments, liabilities or involvement which would be responsive to your questions. Further, we have been advised that Hunt International Resources Corporation had no assets, investments, liabilities or involvement in the silver or silver futures market during the relevant time period of your inquiry.

You will also note that no information is provided for Profit Investment Company, Inc. Profit Investment Company's sole silver-related investment is its fifty percent (50%) ownership position in International Metals Investment Co., Ltd. Accordingly, information pertinent to Profit Investment Company may be discerned from a review of the data for International Metals Investment Co., Ltd.

Information with respect to Placid Oil Company has been previously submitted to the Sub-Committee under separate cover.

The numbered paragraphs below correspond to the numbered paragraphs in your May 9, 1980 letters. Individuals and entities from whom the Sub-Committee has requested information are listed separately.

I. NELSON BUNKER HUNT

A. Silver Related Assets

A-1	8/1/79	1/1/80	3/28/80	5/2/80
Silver Bullion & Silver Coins (Oz.)				
New York (Chase Manhattan, Citibank, Iron Mountain, Irving Trust, Republic National, Swiss Bank Corp.)	3793100	9610400	15837200	9128500
Chicago (Continental Illinois of Chicago, First National Bank of Chicago, Harris Trust)	17155700	17155700	23577300	7706800
New Jersey (Engelhard Minerals & Chemical Corp.)			5930800	-0-
Arizona (North America Coin & Currency)		862700	-0-	-0-
London (Derby & Co., Samuel Montagu; Sharps - Pixley, Johnson-Matthey).			8595000	495000
Total Oz.	20948800	27628800	53940300**	17330300

**According to certain reports, Bache Halsey Stuart Shields, Inc. liquidated 10,236,000 ounces of silver as of the close of business on March 28, 1980, thereby reducing this figure accordingly.

Nelson Bunker Hunt (cont.)

A-2	8/1/79	1/1/80	3/28/80	5/2/80
Silver Futures Contracts				
Comex:				
March, 1980 - Long	11838	12556		
May, 1980 - Long	150	1150	30	
July, 1980 - Short	(2500)	(775)		
July, 1980 - Long				25
Sept., 1980 - Short	(740)	(485)		
Dec., 1980 - Short		(5222)	(1397)	
March, 1981 - Short	(2550)	(308)		
March, 1981 - Long			1003	
	6198	6916	(364)	25
CBOT:				
Feb., 1980 - Long	3030	3100		
April, 1980 - Long	500	521		
Dec., 1980 - Short		(271)		
April, 1981 - Short	(500)	(250)		
	3030	3100		
Total Open Positions Comex & CBOT	9228	10016	(364)	25

A-3	8/1/79	1/1/80	3/28/80	5/2/80
Silver Forward Contracts (Oz.)				
London Metal Exchange				
Merrill Lynch				
March 11, 1980		600000		
March 18, 1980		50000		
April 22, 1980			444000	
April 25, 1980			140000	
July 21, 1980				584000
		650000	584000	584000
ACLI International Commodity Services				
May 6, 1980			1100000	1100000
May 7, 1980			330000	330000
			1430000	1430000
Swiss Bank Corporation-Zurich-Various Dates		750000	3158000	3158000
Total		1400000	5172000	5172000

Nelson Bunker Hunt (cont.)

	8/1/79	1/1/80	3/28/80	5/2/80
A-4				
Contractual Rights to Purchase Silver				
Naji Robert Nahas (oz. of silver bullion)			1407000	1407000
A-5				
Financial Interest - Brokerage Firm				
Bache Halsey Stuart Shields Inc. Shares of Stock (Common)		157600	288350	288350
A-6				
Financial Interest-Following Companies*				
Global Marine Inc. (Shares of Stock)	217050	217050	213000	100650
IMIC (Non-Convertible Debt)				15000000
Profit Investment Co. **				
Shares of Stock (Preferred)	2500	2500	2500	2500
Non-Convertible Debt	5500000	5500000	5500000	5500000

*Nelson Bunker Hunt and Goldfield Corp. entered into an agreement in principle which provided that Nelson Bunker Hunt could purchase a certain number of the shares of Goldfield Corp. for a specified price; further provided that Nelson Bunker Hunt could purchase a 20% interest in a silver mining prospect in New Mexico for a specified price; and granted Nelson Bunker Hunt options for the purchase of an additional 30% interest in the prospect. Mr. Hunt has not exercised any of these rights under the agreement.

A-7

To the best of his knowledge, Nelson Bunker Hunt has no relationship with the National Commodity and Barter Association, Multi-Projects, Ltd., or the American Law Association.

Nelson Bunker Hunt (cont.)

B. Silver Related Liabilities

B-1	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Debts - Brokerage Firms (Outstanding Principal Only)					
Silver Bullion Loans					
ACLI International Inc. - N.Y.					
July, 1976 - Aug. 1979	16529800				
Oct. 1979		39731000	39731000		
Jan. 1980			14064500		
Feb. 1980			9845000		
March, 1980			30014700		
	16529800				2,796,000 oz. Silver Bullio
		39731000			3,131,400 oz. Silver Bullio
			93655200		6,250,400 oz. Silver Bullio
				51155100	7,133,800 oz. Silver Bullio
Bache Halsey Stuart Metal Co. - N.Y.					
Dec. 1973 - Aug. 1979	32010000				
Oct. 1979 -		30000000	30000000		
Jan. 1980			4630300		
Feb. 1980			186800000		
	32010000				4,671,600 oz. Silver Bullio
		30000000			6,362,800 oz. Silver Bullio
			221430300*	-0-	14,768,800 oz. Silver Bullio
E. F. Hutton - N. Y.					
March 1980			87000000*	-0-	6,785,200 oz. Silver Bullio
Mocatta Metals - N. Y.					
Sept. 1976 - March, 1979	24500000	-0-	-0-	-0-	3,182,700 oz. Silver Bullio
Total Silver Bullion Loans	73039800	69731000	402085500	51155100	

*Principal balance prior to liquidation of collateral.

Nelson Bunker Hunt (cont.)

B-1	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Debts - Brokerage Firms (Cont'd)					
Margin Calls					
Heinold Commodities Inc.	-0-		6925600		Treasury Bills 19,250,000
ACLI International	-0-		16049600		*
Merrill Lynch	74600		*		*
Bache Halsey Stuart	125000		*		6250000 oz. Silver Bullion
Paine Webber			15456300		*
Clayton Brokerage Co.	925000				*
Dean Witter Reynolds			8816000		Treasury Bills 8,210,000
A. G. Edwards			5989700		Treasury Bills 1965000
E. F. Hutton			4252200		*
Shearson, Loeb, Rhodes	1195600				*
	2,320000		*		*
Silver Bullion Deliveries					
Bache Halsey Stuart			*		
Total Debts - Brokerage Firms	75359800	69731000	*	51155100	

*Information in dispute; non-verifiable at this time.

B-2	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Debts-Banks (Outstanding Principal Only)					
Citibank, N. A.			25000000	17500000	1739 Bags 90% Silver Coin 659 Bags 40% Silver Coin 10 Bags Silver Dallas
Credit-Lyonnais, N. Y.	10081000	15000000	15000000	-0-	1125400 oz. Silver Bullion
J. Henry Shroder Bank & Trust Co., N.Y.	5000000	8000000	9000000	-0-	1478400 oz. Silver Bullion
Swiss Bank Corp., N.Y.	35000000	-0-	100000000	77388800	4954657 oz. Silver Bullion 8506708 oz. Silver Bullion 8250402 oz. Silver Bullion
First National Bank of Chicago**	10500000	5000000	35000000		
First National Bank in Dallas			18000000	18000000	Various oil & gas leases, stocks, cattle, horses, real property, notes receivable
Total Debts-Banks	60581000	28000000	202000000	112888800	

**Not all of the listed liabilities are silver-related debts.

B-3

	8/1/79	1/1/80	3/26/80	5/2/80
Debts-Other Persons**				
Placid Oil Company			30,000,000	205,973,800

**Hunt Holdings, Inc. (Pentad Resources, Inc.) owed $10,000,000 during period 3/10/80-3/26/80. Also, in connection with an apparent acquisition of silver from Naji Robert Nahas, partially on credit, a purported obligation to Naji Robert Nahas with respect to that acquisition is in dispute.

C. Bank Loans and Lines of Credit

1a. In general, the liabilities discussed at Boca Raton, Florida on March 30, 1980 were those liabilities set forth in response to Question B above.

1b. To the best knowledge of our clients, the bank officers, by name and bank affiliation, with whom these liabilities were discussed, were as follows:

Willard Butcher	- Chase Manhattan
Dick Thomas	- First National Bank of Chicago
William Spencer	- Citibank
Louis Prestige	- Morgan Guaranty
Bob Stuart, Elvis Mason	- First National Bank in Dallas
Mr. McGillicuddy	- Manufacturers Hanover Trust
W. T. Mundt	- Swiss Bank Corporation
	- Bank of America
	- Chemical Bank
	- Continental Illinois of Chicago

C2. Attached hereto is a copy of an Agreement of Limited Partnership of Placid Investments, Ltd. among Placid Investment Company, as General Partner and Nelson Bunker Hunt, William Herbert Hunt and Lamar Hunt, as Limited Partners. This Agreement is responsive to your questions with respect to the partnership.

C3. Attached hereto is a copy of the Revolving Credit Agreement among Placid Oil Company as Borrower, First National Bank in Dallas and Morgan Guaranty Trust Company of New York as Agents and Thirteen Banks as Lenders. This document is responsive to your questions with respect to the loan arrangements.

II. WILLIAM HERBERT HUNT

A. Silver Related Assets

A-1

Silver Bullion & Silver Coins (Oz.)	8/1/79	1/1/80	3/26/80	5/2/80
New York	4483400	4483400	9645500	7549600
Chicago	16464000	16623200	22873100	17188700
New Jersey			2570000	
Arizona		862700		
London			1450000	
Total Oz.	20947400	21969300	36538600	24738300

William Herbert Hunt (cont.)

A-2	8/1/79	1/1/80	3/28/80	5/2/80
Silver Futures Contracts				
Comex:				
Sept. 1979 - Long	115			
Dec. 1979 - Long	250			
Jan. 1980 - Long	200	250		
March 1980 - Long	330	647		
May 1980 - Long	7114	7379	1203	
July 1980 - Short	(4544)	(4424)	(1846)	(943)
Sept. 1980 - Long		33	33	
March 1981 - Long			25	
May 1981 - Long			336	500
July 1981 - Long				394
	3465	3885	(249)	(49)
CBOT:				
Oct. 1979 - Long	31			
Dec. 1979 - Long	49			
Feb. 1980 - Long	2266	2266		
April 1980 - Short	(1420)	(1360)	(507)	
Dec. 1980 - Long		49	49	
Feb. 1981 - Long				49
	926	955	(458)	49
Total Open Positions - Comex & CBOT	4391	4840	(707)	-0-

A-3				
Silver Forward Contracts (Oz.)				
London Metal Exchange				
Merrill Lynch:				
March 11, 1980		600000		
March 18, 1980		50000		
April 22, 1980			443000	
April 25, 1980			140000	
July 21, 1980				583000
		650000	583000	583000
ACLI International Commodity Services				
May 6, 1980			330000	330000
Swiss Bank Corporation - Zurich-Various Dates	-0-	750000	3158000	3158000
Total	-0-	1400000	4071000	4071000

William Herbert Hunt (cont.)

	8/1/79	1/1/80	3/28/89	5/2/80
A-4				
Contractual Rights to Purchase Silver				
Naji Robert Nahas (oz. of silver bullion)			845000	845000
A-5				
Financial Interest-Brokerage Firms				
Bache Halsey Stuart Shields Inc. (Common)				
Shares of Stock		157600	288250	288250
A-6				
Financial Interest-Following Companies				
Global Marine Inc.				
Shares of Stock (Common)	217050	217050	213000	300650
Profit Investment Co.				
Shares of Stock (Preferred)	2500	2500	2500	2500
Debt Investments (Non-Convertible)	5500000	5500000	5500000	5500000

A-7

To the best of his knowledge, William Herbert Hunt has no relationship with the National Commodity and Barter Association, Multi-Projects Ltd., or the American Law Association.

William Herbert Hunt (cont.)

B. Silver Related Liabilities

B-1 Debts - Brokerage Firms (Outstanding Principal Only)	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Silver Bullion Loans					
ACLI International Inc. - N.Y.					
July, 1976 - Aug. 1979	13309200				
October, 1979		26559800	26559800		
Feb., 1980			10000000		
March, 1980		-0-	4043000		
	13309200	26559800	40602800	38102800	2251300 Oz. Silver Bullio 3142300 Oz. Silver Bullio 3881000 Oz. Silver Bullio
Bache Halsey Stuart Metal Co. - N.Y.					
Dec. 1973 - Aug. 1979	3199700				
October, 1979		7000000	7000000		
Feb. 1980			5000000		
	3199700	7000000	12000000**	-0-	580900 Oz. Silver Bullio 4128900 Oz. Silver Bullio
Clayton Brokerage Co. - St. Louis					
October, 1976 - Aug. 1979	37306900	-0-	-0-	-0-	5724700 Oz. Silver Bullio
E. F. Hutton - N.Y.					
March, 1980			13000000**	-0-	2058700 Oz. Silver Bullio
Merrill Lynch - N.Y.					
January, 1980			26000000		
March, 1980			76501200		
			102501200	75777700	8219600 Oz. Silver Bullio
Mocatta Metals					
Sept., 1976 - March, 1979	25900000	-0-	-0-	-0-	5529100 Oz. Silver Bullio
Total	79715800	168104000	16810400	113880500	

**Principal balance prior to liquidation of collateral.

William Herbert Hunt (cont.)

Silver Related Liabilities

B-1 Debts - Brokerage Firms (Cont'd)	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Margin Calls					
Merrill Lynch			*		*
Roche Haloey Stuart			*		316600 oz. Silver Bullion
Paine Webber			10237000		
Cargill Investor Services			1919600		
ACLI International			3712900	4070200	
Dean Witter Reynolds			8348900		Treasury Bills 7,900,000
Clayton	57100				
Total	57100		24218400		
Total Debts - Brokerage Firms	79772900	33559800	192322400	117950700	

*Information in dispute; non-verifiable at this time.

B-2 Debts- Banks (Outstanding Principal Only)	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Citibank, N. A. - N.Y.			25000000	17500000	1739 Bags 90% Silver Coin: 659 Bags 40% Silver Coin: 10 Bags Silver Dollars 1300600 oz. Silver Bullion
Credit Lyonnais - N.Y.			15000000	-0-	1043300 oz. Silver Bullion
Swiss Bank Corp. - N.Y.	35000000	-0-			6483100 oz. Silver Bullion
			100000000		10112600 oz. Silver Bullion
				89468000	9538170 oz. Silver Bullion
First National Bank in Dallas			2000000	2000000	Oil, gas & coal leases, stocks, real property, notes receivable
First National Bank of Chicago	19500000	5000000	15000000	-0-	
Total Debts - Banks	54500000	5000000	157000000	108968000	

B-3 Debts - Other Persons (Outstanding Principal Only) **	3/28/80	5/2/80
Nelson Bunker Hunt	40500000	50000000
Placid Oil Company	55000000	135088600
Total Debts - Others	95500000	185088600

**Hunt Holdings, Inc. (Pentad Resources, Inc.) owed $10,000,000 from period 3/10/80-3/26/80.
Also, in connection with an apparent acquisition of silver from Naji Robert Nahas, partially on credit, a purported obligation to Naji Robert Nahas with respect to that acquisition is in dispute.

William Herbert Hunt (cont.)

C. Bank Loans and Lines of Credit

See responses of Nelson Bunker Hunt.

III. INTERNATIONAL METALS INVESTMENT CO., LTD.

A. Silver Related Assets

	8/1/79	1/1/80	3/28/80	5/2/80
A-1 Silver Bullion & Silver Coins				
New York		5643000	4625000	4170000
Chicago		4804000	4203000	4203000
Various U. S. Banks		7537000	7537000	7537000
London		10030000	6164000	6164000
Zurich		8991000	9496000	7061000
		3700500	32025000	29135000
A-2 Silver Futures Contracts				
Comex:				
Sept, 1979 - Long	50			
Dec., 1979 - Long	261			
May, 1980 - Long		881	367	
July, 1980 - Long	200	1000	727	
Sept., 1980 - Long		135	135	105
	511	2016	1229	105
CBOT:				
Oct., 1979 - Long	75			
Dec., 1979 - Long	296			
April, 1980 - Long		576	431	
June, 1980 - Long	200	990	990	146
Aug., 1980 - Long		226	226	226
	571	1792	1647	372
Total Open Positions - Comex and CBOT	1082	3808	2676	477
A-3 Silver Forward Contracts (Oz.)				
London Metal Exchange				
Merrill Lynch				
March 11, 1980		600000		
March 18, 1980		50000		
April 22, 1980			443000	
April 25, 1980			140000	
		650000	583000	

International Metals Investment Co. Ltd. (cont.)

	8/2/79	1/1/80	3/28/80	5/2/80
ACLI International Commodity Services				
May 6, 1980			330000	
Swiss Bank Corporation-Zurich				
May 14, 1980			333000	333000
May 19, 1980			117000	117000
June 3, 1980			83000	83000
			533000	533000
Mocatta Metals Corporation - New York				
Jan. 4, 1980		140000		
Jan. 21, 1980		70000		
Jan. 31, 1980		150000		
Feb. 4, 1980		85000		
Feb. 29, 1980		150000		
Mar. 3, 1980		65000		
Mar. 31, 1980		150000	150000	
April 1, 1980		40000	40000	
April 30, 1980		150000	150000	
May 5 through Dec. 31,,1980		4178000	4178000	4178000
		5178000	4518000	4178000
		5828000	5964000	4711000

International Metals Investment Co., Ltd. (cont.)

B. Silver Related Liabilities

	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
B-1					
Debts - Brokerage Related (Outstanding Principal Only)					
Merrill Lynch	-0-	50000000			4,390,000 oz. Silver Bullion;
			287750000		146,100,000 oz. Silver Bullion; Coins; 3200 oz. Gold; Treasury Bills of 166,000,000
				199529000	13,080,000 oz. Silver Bullion; Coins; 3200 oz. Gold; Treasury Bills of 44,000,000
B-2					
Bank Debt-Silver Related (Outstanding Principal Only)					
Schroder Bank-Zurich		10000000	20000000	20000000	2,367,400 oz. Silver Bullion
Bank Arab Internationl Inc.-Paris			10000000	10000000	1,435,500 oz. Silver Bullion
Saudi Finance Corporation-Paris			26000000		2,468,500 oz. Silver Bullion
Bank Leu-Zurich			50000000	21401000	2,783,750 oz. Silver Bullion
Citibank-New York		25000000	40000000	40000000	2,580,000 oz. Silver Bullion
Swiss Bank Corporation		150000000			3,185,000 oz. Silver Bullion
First National Bank-Dallas			15000000		Guaranteed by N. B. Hunt
		185000000	161000000	91401000	
B-3					
Other Debts-Silver Related (Outstanding Principal Only)					
Mocatta Metals Corporation		25482060	17677000	13855550	Silver Forwards Contracts
Various U.S. Banks on Coin Options		12003000	12003000	12003000	Silver Coins
N. B. Hunt				15000000	
Subordinated Loans from Shareholders	20000000	20000000	20000000	20000000	
	20000000	57485060	49680000	60858550	

IV. HUNT INTERNATIONAL MINERALS LTD.

A. Silver Related Assets

A-1	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Silver Bullion (Oz.)					
New York	504900	504900	504900	-0-	
A-2					
Silver Futures Contracts					
Comex:					
May 1980	54	54	-0-	-0-	

B. Silver Related Liabilities

B-1	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Debts - Brokerage Firms (Outstanding Principal Only)					
Silver Bullion Loans					
Bache Halsey Stuart Metal Co., March 1975-Aug. 1979	2759300	2759300	-0-	-0-	504900 Oz. Silver Bullion
Margin Calls					
Bache Halsey Stuart Shields, N.Y.			*		
Total Debts - Brokerage Firms	2739300	2759300	*	-0-	

*Information in dispute; non-verifiable at this time.

V. PLANET INVESTMENT CORPORATION

A. Silver Related Assets

A-1	8/1/79	1/1/80	3/28/89	5/2/80
Silver Bullion (oz.)				
Swiss Bank Corporation	3,000,000	3,000,000	3,000,000	
First of Chicago, Continental Illinois Bank				3,003,359.19

Planet Investment Corp. (cont.)

B. Silver Related Liabilities

Planet Investment Corporation has a non-silver related obligation to Manufacturers Hanover Trust Company which is secured by substantially all of its assets, including the 3,000,000 ounces of silver bullion, and such obligation is further guaranteed by N. B. Hunt and W. H. Hunt.

The foregoing information submitted to you on behalf of our clients is based upon their best knowledge and information available to them at this time. While our clients believe that the information set forth in this letter is accurate, they, nevertheless cannot at this time confirm or insure either its accuracy or completeness. This is so because:

(a) the information was compiled from data secured primarily from third parties;

(b) the information was gathered by persons other than our clients, and

(c) the time frame within which the information was gathered was limited.

The foregoing information, together with copies of the agreements attached hereto, should satisfy the questions raised in your May 9, 1980 letters. Please consider this information as confidential and intended solely for the purposes and use of your Sub-Committee.

Respectfully submitted,

Roger Goldburg

RG:hm

cc: N. B. Hunt
W. H. Hunt

PLACID OIL COMPANY
1600 FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202

May 30, 1980

Mr. Nelson Bunker Hunt
2500 First National Bank Bldg.
Dallas, Texas 75202

Dear Mr. Hunt:

You have furnished the officers of Placid Oil Company ("Placid") a copy of the May 9, 1980 letter (the "Request Letter") to you from Benjamin S. Rosenthal, Chairman of the Commerce, Consumer and Monetary Affairs Subcommittee (the "Subcommittee") of the Committee on Government Operations of the House of Representatives and have requested that Placid furnish you the data, information or documents called for by the Request Letter insofar as they relate to Placid and its subsidiaries.

Please be advised that the Custodian of Records of Placid has made, or caused to be made, a diligent and careful search of the records, documents and information in his custody, possession or control and has caused to be prepared the data and information, and has caused to be produced the documents, set forth or described below.

Data and information given or documents described herein are grouped under the alphabetical and numberical categories set forth in the Request Letter. Where a document is described, a true and correct copy of that document is attached hereto. The data and information furnished and documents described are from the dates mentioned in the Request Letter through May 9, 1980, the date of the Request Letter. No information or documents subsequent to May 9, 1980 are furnished or described. Where an item in the Request Letter is not responded to, the answer is in the negative or the question is not applicable to Placid and its subsidiaries. Following is all such data and information, and a description of documents, which are in the opinion of the Custodian of Records of Placid called for by the Request Letter as to Placid and its subsidiaries.

A. 2. Information with respect to silver futures contracts for Eighth Crescent Investment Company, an indirect wholly-owned subsidiary of Placid:

Date	Position	Number of Contracts	Delivery Month	Exchange
August 1, 1979	None	-	-	-
January 1, 1980	None	-	-	-
March 28, 1980	Long	125	December 1980	Comex
May 2, 1980	Long	125	December 1980	Comex

A. 6. Financial interest in or investment by Placid (through indirect wholly-owned subsidiaries) with respect to:

i. Gulf Resources and Chemical Corporation.

Date	Aggregate Number of Shares Owned	Aggregate Cost of Investment
August 1, 1979	None	None
January 1, 1980	687,500	$ 13,072,587
March 28, 1980	806,100	15,591,977
May 2, 1980	806,100	15,591,977

vi. Louisiana Land and Exploration Company.

Date	Aggregate Number of Shares Owned	Aggregate Cost of Investment
August 1, 1979	1,850,000	$ 54,139,837
January 1, 1980	3,498,600	130,604,541
March 28, 1980	3,498,600	130,604,541
May 2, 1980	3,498,600	130,604,541

B. 1. Silver related liabilities, debts and contractual obligations of Placid and its subsidiaries to brokerage firms or brokerage firms' affiliates:

None, except price differential obligations of Eighth Crescent Investment Company, an indirect wholly-owned subsidiary of Placid, under Comex rules with respect to 125 silver futures contracts referred to under paragraph A. 2. above (Broker: Merrill Lynch Pierce Fenner & Smith Inc.).

C. 2. Partnership arrangements.

Partnership Commitment Letter, dated April 30, 1980 between Placid and N. B. Hunt, W. H. Hunt and Lamar Hunt. (Copy attached).

C. 3. Bank or other creditors participating in actual loans and/or lines of credit to Placid between March 28, 1980 and May 9, 1980.

Name of Bank	Amount Loaned	Date
Citibank, N.A.	$25,000,000(1)	March 31, 1980
Citibank, N.A.	40,000,000(1)	April 1, 1980
First National Bank in Dallas	3,750,000(2)	April 8, 1980
Citibank, N.A.	56,250,000(2)	April 8, 1980
Chemical Bank	18,750,000(2)	April 8, 1980
Bank of America, N.T.S.A.	37,500,000(2)	April 8, 1980
Continental Illinois National Bank	26,250,000(2)	April 8, 1980
The First National Bank of Chicago	26,250,000(2)	April 8, 1980
Manufacturers Hanover Trust Co.	37,500,000(2)	April 8, 1980
Chase Manhattan Bank, N.A.	56,250,000(2)	April 8, 1980
Morgan Guaranty Trust Co. of N.Y.	37,500,000(2)	April 8, 1980
Morgan Guaranty Trust Co. of N.Y.	5,000,000(3)	April 28, 1980
Chase Manhattan Bank, N.A.	5,000,000(3)	April 28, 1980
Manufacturers Hanover Trust Co.	5,000,000(3)	April 28, 1980

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(1) $50,000,000 repaid April 3, 1980. Copies of Advice of Credits and Debit attached.

(2) Copy of Interim Demand Note attached.

(3) Advanced pursuant to a $10,000,000 line of credit for working capital. Copy of commitment letter attached and note attached.

Additionally, there was executed a Bank Commitment Letter, dated May 1, 1980, between Placid and First National Bank in Dallas, as Lender and as Agent, Morgan Guaranty Trust Company of New York, as Lender and as Agent, and eleven other Banks, relating to $1,100,000,000 of loans to Placid. (Copy attached).

- - - - - - - - - - - - - - - -

If you so desire, you are authorized to deliver a copy of this letter and copies of the documents delivered herewith, or to give the information set forth herein, to the Subcommittee; however, since you and William Herbert Hunt are neither officers, directors or shareholders of or agents for Placid or any of its subsidiaries, this letter (except as set forth herein) does not authorize you to act or respond on behalf of Placid and its subsidiaries.

Very truly yours,

Paul W. Hicks

Paul W. Hicks,
Secretary and General Counsel,
Custodian of Records

SUBSCRIBED AND SWORN TO BEFORE ME this 31st day of May, 1980, to certify which witness my hand and seal of office.

Jean C. Ricketts

Notary Public in and for Dallas County, Texas

Notary Public In and
for Dallas County, Texas
My Commission Expires: 5-20-81

Mr. **St Germain**. Mr. Hunt, W. H. Hunt.

Mr. W. H. **Hunt**. Yes, sir.

Mr. **St Germain**. Have you borrowed money from banks where the security is silver? Not brokerage houses, I am talking about banks.

Mr. W. H. **Hunt**. Yes, but most of my loans are with brokerage houses who in turn have placed with banks. I don't know who they are.

Mr. **St Germain**. I understand that. I will get that from the brokerage houses. If indeed you have borrowed moneys from banks secured by silver, you yourself, not through the brokerage houses, would you supply the names of those banks for the record?

Mr. W. H. **Hunt**. As of what date, Congressman?

Mr. **St Germain**. As of this date.

Mr. W. H. **Hunt**. Fine.

Mr. **St Germain**. I imagine since the Placid loan hasn't gone through, the partnership doesn't have the money. I would assume you have not repaid. Staff just suggests that we ask for the period between January 1, 1980, and this date.

Mr. **Goldburg**. Mr.——

Mr. **St Germain**. Does counsel have any objection?

Mr. **Goldburg**. No.

Mr. **Rosenthal**. Mr. Deckard.

Mr. **Deckard**. Yes, I would like to ask again about these two loans and clarify which of the two was collateralized by silver, which it would have been, the first or the second.

Mr. W. H. **Hunt**. I am sorry, Congressman Deckard, we are back to the problem I am having. I don't know what you are referring to as first and second.

Mr. **Deckard**. The loans that you yourself referred to as the first and second loans earlier in your testimony, that the most recent loan was used to retire bank loans that were an obligation of Placid Oil Co.

Mr. W. H. **Hunt**. All right, let's talk about——

Mr. **Deckard**. One of the loans was collateralized with primarily oil and gas holdings. One of the loans was collateralized with silver. I want to clarify which one is which.

Mr. W. H. **Hunt**. OK. The Placid loan is collateralized with oil and gas properties.

Mr. **Deckard**. The one that has just been satisfied by virtue of this most recent loan?

Mr. W. H. **Hunt**. Correct.

Mr. **Deckard**. So this most recent loan is collateralized by silver?

Mr. W. H. **Hunt**. No, no. OK, let me see if I can reexplain.

Mr. **Deckard**. Well, let me try to clarify a response that was given to Mr. Levitas earlier. Mr. Nelson Bunker Hunt was asked whether the first debt was in some manner related to silver. Mr. Nelson Bunker Hunt replied "Yes". The lawyer for W. H. Hunt shook his head "No". I wonder what the discrepancy was there.

Mr. **Goldburg**. I think my client can articulate what I think is the problem on the record here and confusion, if you don't mind. I respectfully would like him to respond and try to clarify what I think you are referring to as two loans. I don't think there is any testimony in this record at least that is not confused that relates to two loans. One was a proposed transaction which was discussed in Florida, and the other is what I refer to as the Placid loan, which Mr. Hunt has articulated the details of for your edification this morning.

Isn't that the state of the record, sir?

Mr. DECKARD. I am sorry, I am having difficulty with this point. I think I will turn it over to you, Mr. Chairman. Thank you.

Mr. ROSENTHAL. I want to thank both of you and your counsel for being with us this morning and for being reasonably cooperative. It is distressing, some of the significant kinds of things you didn't have at your fingertips, but hopefully you will be able to provide much of it for the record.

We adjourn today's hearings with the understanding that you are subject to recall under the subpena of April 23, 1980, under which you appear here today, and that you will continue to cooperate with the subcommittee including the timely furnishing of the data and information requested here today which we will specify by letter, and any other information that is necessary.

[Whereupon, at 1:04 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

SILVER PRICES AND THE ADEQUACY OF FEDERAL ACTIONS IN THE MARKETPLACE, 1979–80

THURSDAY, MAY 22, 1980

House of Representatives,
Commerce, Consumer,
and Monetary Affairs Subcommittee
of the Committee on Government Operations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2203, Rayburn House Office Building, Hon. Benjamin S. Rosenthal (chairman of the subcommittee) presiding.

Present: Representatives Benjamin S. Rosenthal, Lyle Williams, Jim Jeffries, and Joel Deckard.

Also present: Barbara Timmer, counsel; Doris Faye Ballard, clerk; and Jack Shaw, minority professional staff, Committee on Government Operations.

Mr. Rosenthal. The subcommittee will be in order.

Today, the Commerce, Consumer, and Monetary Affairs Subcommittee continues its investigation into the adequacy of the Federal response to recent events in the silver and related financial markets.

The subcommittee has asked Deputy Secretary Carswell to explain Treasury's role and responsibility for precious metals, including silver, and how excessive speculation in any market adds to inflationary pressures and economic instability.

In addition, the explosive growth since late 1975 of trading in interest rate futures, particularly Treasury bills, has the potential to seriously impact and inhibit Treasury's primary debt management responsibility.

The markets for futures contracts based on U.S. Government securities have become the largest trading markets in the world, but the major problems Treasury recognized at their inception still remain unresolved:

Inadequate investor safeguards, a proliferation and duplication of contracts, and a lessening of self-regulation as exchanges compete to promote their products.

In fact, the possibility of manipulative trading practices or a corner in Government-backed securities is as real as the March silver spectacle.

The subcommittee has asked Commissioner Kurtz of Internal Revenue Service and Secretary Carswell of the Department of the Treasury to discuss the extent to which futures markets are being used to avoid taxes and IRS proposals to identify and eliminate abusive tax shelters in futures trading.

We are honored that both of you could be with us and, Mr. Carswell, we are happy to hear from you.

STATEMENT OF ROBERT CARSWELL, DEPUTY SECRETARY FOR MONETARY AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. CARSWELL. Thank you, Mr. Chairman.

I welcome this opportunity to discuss the Treasury's role in the recent developments in the commodity futures markets as Treasury shares this committee's concerns about orderly markets.

In my statement today, I will try to address the major issues raised in your questions submitted to us in your letter of May 15. In the coming weeks, we will work with your staff to address those matters that I do not cover today.

The Treasury Department has no specific statutory authority over any market for commodities or commodities futures or any participant in those markets. As this committee is aware, the Treasury's initial concern with the rapidly developing futures markets centered on the potential impact such markets might have on Treasury's debt management flexibility and on the underlying cash market for Government securities.

However, the recent developments in the market for silver futures and the rapid proliferation of new futures, forwards and options contracts have raised broad issues about the stability and orderly development of all those markets.

Historically, Treasury has had an interest in the precious metals markets. As the custodian of the Nation's reserves of gold and the Cabinet agency responsible for international monetary policy, Treasury closely and continually monitors the markets for gold.

Treasury was similarly concerned with the silver markets, but by 1970 silver had been eliminated from our new circulating coinage and most of the Nation's then remaining silver reserve had been sold in the market or transferred to the General Services Administration.

Treasury purchases copper for coinage and has conducted a gold auction program since May 1978, but otherwise is not directly involved in transactions relating to commodities.

In the Futures Act of 1978, the Commodity Futures Trading Commission was required to consult with Treasury prior to designation of new contract markets involving transactions in any security issued or guaranteed by the United States or any agency thereof and with respect to certain other actions.

Treasury's interest in these financial futures is clear and the Treasury had sought a much stronger role. We recommended that the Secretary of the Treasury be given a veto authority over contract market designations. The act as passed, however, did not give the Treasury this authority nor any role in markets relating to commodity futures, as opposed to financial futures.

Because Treasury engages in extensive monitoring of and operations in the foreign exchange markets, it also closely watches the markets for futures involving foreign currencies but, again, it has no statutory responsibility for that area.

More generally, because the Secretary of the Treasury is the chief financial officer of the Government, the Treasury Department has a keen interest in the efficient operation of all financial markets.

Excessive speculation in any market that adds to inflationary pressures and expectations or which might destabilize other markets is within the purview of the Secretary. And traditionally Treasury officials have monitored markets, including the commodity markets, with those concerns in mind.

In summary, the Treasury presently has no statutory responsibility or authority to do anything in the commodities futures markets. It is a direct participant in the gold markets and has an advisory role with respect to contracts involving future delivery of U.S. Government and Government-guaranteed securities.

Next, Mr. Chairman, I will address the activities of the Department relating to silver during the 6 months prior to March 27.

As you will recall, the gold market was subject to considerable speculative activity during 1979. In October 1979, at his initiative then Under Secretary of the Treasury Anthony Solomon met with representatives of the CFTC to discuss developments in the gold and, to a lesser degree, the silver markets.

The World Bank and the International Monetary Fund had just concluded their annual meetings in Belgrade, and representatives of several countries had expressed concerns about the runup of both gold and silver prices and the implications for inflation and the exchange markets.

The speculative nature of trading in these markets was discussed as well as the possible need for regulatory measures, including higher margin requirements on futures contracts for silver. Treasury had no information regarding the size or value of anyone's position, nor was our assistance requested with respect to the situation.

There were numerous staff contacts with representatives of the CFTC during the fall and winter, principally concerning the markets in financial futures pursuant to the statutory responsibilities I referred to earlier. It is possible that in some of those meetings there also may have been some discussion of the situation in silver, but I have no personal knowledge of such contacts, nor have we been able to find any record of any.

My personal involvement in the silver situation commenced on the afternoon of Wednesday, March 26, 1980, when I received a call from Chairman Volcker in which he reported that a leading brokerage house might be in difficulty because the Hunt interests were failing to meet substantial margin calls.

Prior to that call, I had been generally aware of intensified speculative activity in the silver market, but I had no direct contact with either the CFTC or any other regulatory agency about this subject.

In fact, in my testimony before another committee in February, I stated only that both anecdotal evidence and the volatile prices in many of the futures markets was indicative of an increased level of speculative activity and was cause for concern.

In the days following March 26, I conferred frequently by telephone or in person with Chairman Volcker and the Chairmen of the Commodity Futures Trading Commission and the Securities and Exchange Commission.

I did this because of the general responsibility of the Treasury to keep abreast of matters that might have the potential of destabilizing the financial markets and to take action that might be appropriate.

I also conferred by telephone on numerous occasions with officials of the New York Stock Exchange and on several occasions with representatives of brokerage houses who were involved.

Similarly, I discussed possible bank involvement or vulnerability with the Comptroller of the Currency, whose office is administratively part of the Treasury Department.

While in the beginning the situation was unclear, it was Secretary Miller's and my conclusion that the Treasury Department should not intervene—and we did not—with the Commodity Futures Trading Commission to recommend the suspension of trading in silver futures contracts either by the Commodity Futures Trading Commission or by any exchange or take any other overt action.

Generally speaking, the purpose of the Treasury Department in following this matter so closely was to help assure that appropriate and timely action was taken by all who might have responsibilities and, if emergency action were necessary, to recommend same to the President. As I earlier stated, at no time did we conclude any intervention was required by the Treasury.

As to the commodity markets and the commodity futures markets themselves, the administration has been concerned for some time that the speculative trading in those markets may well have contributed to inflation directly and, just as importantly, to inflationary expectations.

For example, precious metals accounted for about 0.5 percent of the 1.6-percent increase in the Producer Products Index in January. The increases feed through the production process and result in price increases in some products which are not necessarily reduced when commodity prices themselves go down.

Furthermore, these price increases can result in subsequent increases in wage and price contracts tied to the price indices, further exacerbating inflation.

It is unrealistic to expect that any market will operate perfectly, but when leveraged speculation based on inflationary expectations results in extraordinarily wide swings or the fear of a corner unduly raises prices, the effect on the whole economy is unnecessarily disruptive. Hence, from the overall standpoint of moderating inflation, any measures that would tend to insure that the markets operated in an orderly and efficient fashion would be useful.

An additional concern is that when any market operates in an aberrational fashion, that can have disruptive effects in other markets. Thus, if forced liquidations of positions on the commodity markets should result in bankruptcies of some participants, those bankruptcies could have ripple effects in other markets and cause significant problems.

While such ripple effects have been thus far contained in the recent silver incident, the risk of their spreading is present whenever unbridled speculation results in precipitous price movements. Similarly, if the financial futures markets should operate in a prejudicial way, that could impact the cash market for Treasury securities.

The Treasury market is the bellwether market of our financial system and it would not be in the national interest to have that market adversely affected by speculative trading in a futures market.

Futures markets in foreign currencies raise additional questions, since activities in these highly volatile markets relate to developments in foreign countries as well as in our own domestic economy. We are concerned about the lack of scrutiny and analysis in this widely dispersed area.

Foreign currency markets affect important international relations, and futures market activity in foreign currencies that adversely impact these markets could affect the operation of the international monetary system. There is a need for greater understanding and involvement in foreign currency futures by those responsible for overseeing international monetary developments.

The Treasury has a special interest in what appears to have been a substantial increase in futures trading activities solely for the purpose of minimizing Federal taxes.

It is difficult to generalize about the possible effects of tax motivated transactions on the underlying markets. Some types of transactions, such as the recent surge of activity in the 3-month Treasury bill futures, appear to have distorted the market price for the underlying security in the cash market.

Others, because they are essentially fictitious in nature, may simply provide an illusion of increased trading activity and have no substantive economic effect. Trading in the futures market for tax purposes is nothing new. The use of commodity straddles to minimize taxes has been promoted for some time. Certain types of straddles which are wholly tax motivated are not permitted by the IRS when they allow taxpayers to take losses they have not suffered economically.

Schemes designed for tax deferral or tax avoidance have become increasingly complex and sophisticated and, with what appears to be a significant increase in volume, this type of trading may well represent a major tax avoidance area.

Commissioner Kurtz will be discussing in more detail the specifics of this area and the approaches that Treasury and the Service have taken and will continue to take to prevent the perversion of the tax system and the markets that should operate for economic purposes rather than fictitious tax purposes.

I would also suggest that it would be beneficial for both the leaders of the futures industry and the regulators of the industry to recognize that failure to curb this kind of abuse will in the end undermine the industry itself, because the public as a whole cannot be expected to countenance activities that are claimed to prefer one class of income over another without any economic justification.

Finally, Treasury remains concerned about the proliferation generally of new contracts involving future delivery or that refer to future market prices of financial instruments, currencies or indices.

These have taken the form of forward contracts, contracts for future delivery or performance and of options on both types of contracts. Some of these markets are just getting started; others have grown very rapidly in the last 2 years. For instance, the 3-month Treasury bill future contract volume exceeds the cash market in that area, the level of trading now being at about $2 trillion annually and, based on the trading levels in the last week, it will be $3 trillion this year.

As I advised the House Agriculture Committee in February, rapid developments in these markets and explosive growth have created considerable uncertainties and placed a heavy and increasing burden on the CFTC and its responsibilities for governance. It has happened so quickly that the full significance is not yet known.

Our concerns with these markets have not diminished and, as I stated in February, we are uncertain that the present regulatory structure is able to cope with this growth and all potential problems. Although we are as close as any Federal agency to these markets, we do not fully understand them. We do not know who the participants are, what they are doing, or what economic purpose is being served.

We are doubtful that anyone knows the answers to these questions and have therefore suggested that developments be carefully monitored and that new contracts not be liberally designated.

In this circumstance, the Treasury, the Federal Reserve Board and the Securities and Exchange Commission have formed a working group and with the help of the CFTC we intend to evaluate various aspects of this complex situation and arrive at conclusions as to what, if any, legislative action would be appropriate.

The group has already met several times and consulted with various persons outside of the executive branch. The same group will shortly complete a study conducted over the past 3 months of the Ginnie Mae forward contract market. That study will provide some suggestions for dealing with some of the problems in that area.

You have also asked for our views on several specific proposals for legislation and the possible need for additional regulatory authority over futures markets and related markets. While we are not in a position to make definite recommendations at this time, I would like to make several brief comments.

Margins play a role in the futures markets different from their role in the cash markets for equities and debt instruments. Unlike the cash market, where margin determines the level of credit extended to pay for securities, in the futures market, margins act as a performance bond for future payments.

Furthermore, in the futures area, there is an additional difference between the initial margin, or earnest money, and the maintenance margin which serves to asssure that contracts are marked to market by daily cash settlement of gains and losses. Easy analogies are likely to be deceptive.

It is also clear to us, after relatively brief study, that the design of margins, whether to regulate credit or to assure performance, may be subject to quite different considerations if a tangible commodity is involved, as opposed to a financial future.

Similarly, the necessity or desirability of position limits may also turn on the type of market involved. This is not to say that a revised regulatory scheme for margins and position limits may not be desirable, but the construction of a new system should take account of the very different basic markets involved and the likely evolution of these markets.

Before making any legislative proposal or supporting any proposal, we believe it is essential that the markets and the regulatory processes be properly analyzed. We are proceeding with that task.

These are large, complex and important issues. There is a relationship between the immediate concerns arising out of developments in the silver market and those being addressed by a number of other regulatory bodies and congressional committees.

The concerns in the futures area are closely related to those in the forward market area and the options markets. In the options area regulatory jurisdiction is split between the SEC and the CFTC with some areas remaining unregulated. Both the securities and the commodities industries are proposing and planning increases in options trading.

We would suggest that a piecemeal approach, without understanding of the full implications of actions, might well compound rather than facilitate resolution of the challenges facing these markets.

Thank you, Mr. Chairman.

Mr. ROSENTHAL. Thank you very much, Mr. Secretary, for what I think was a very thoughtful and decisive statement.

Commissioner Kurtz?

STATEMENT OF JEROME KURTZ, COMMISSIONER, INTERNAL REVENUE SERVICE; ACCOMPANIED BY JEROLD COHEN, CHIEF COUNSEL

Mr. KURTZ. Thank you, Mr. Chairman and members of the committee.

I am pleased to appear before you today to discuss the Internal Revenue Service's experience with certain tax-motivated commodity transactions. The IRS is concerned with the effect of such transactions on the proper functioning of the income tax system.

Certain transactions in commodities have been promoted as a device for sheltering current income with little or no risk of economic loss. Commodities shelters purport to reduce current taxes either by deferring income to a later year or by converting ordinary income into capital gain.

A taxpayer who can defer the payment of tax obtains a significant economic benefit; he receives the equivalent of an interest-free loan from the Government for the period of deferral. The conversion of ordinary income into capital gain is a more obvious benefit because of the substantially higher rate on tax imposed on ordinary income.

Although some of these schemes may become very complicated, the basis for the claimed benefit can be illustrated by a description of a basic commodity tax straddle, which I might add, in itself, is complicated.

Mr. ROSENTHAL. Can you go slow so we can try and understand this.

Where do they get the word "straddle"?

Mr. KURTZ. That is what I am coming to.

In a typical commodity straddle, such as silver, the taxpayer buys and sells equal amounts of commodity futures contracts simultaneously on a commodity exchange. Risk is limited or even eliminated because, although the price of a commodity may gyrate wildly, the spread between two contracts, the buy contract and the sell contract to deliver the commodity in different future months remains fairly constant.

For example, the taxpayer, on August 1, buys long 40 silver futures contracts for March of the following year; under these contracts, the taxpayer is required to purchase silver at a fixed price in March of the following year, and sells short 40 silver future contracts for July of the next year.

Under these contracts, the taxpayer is required to deliver the same quantity of silver next July. He has two contracts, one requiring him to buy silver next March and one requiring him to sell silver next July in the same amounts.

Any price change in the commodity will cause offsetting increases and decreases in the value of the two sides or legs of the transaction. If the price of silver goes up, the long contract will increase in value because the taxpayer holds the right to purchase at a price lower than the market price, and the short contract will decrease in value because the cost of fulfilling the obligation to deliver the silver is greater than the price at which the taxpayer is obligated to sell the silver.

If the commodity price goes down, the converse is true. Thus, a taxpayer engaged in a commodity straddle is exposed to a minimal market risk.

It is significant to note that the taxpayer does not care whether the price of silver goes up or goes down. Actually, his only concern is that it move one way or the other. Once the price moves, the taxpayer will have an unrealized loss on one leg of the transaction and an unrealized gain of a roughly equivalent amount on the other.

Let's assume the price of silver falls. The long position then becomes a losing position because the taxpayer is obligated to purchase at a price greater than the market. The taxpayer closes out his long position, the "loss" leg. The closed out position then is immediately replaced with a long position for a different month, such as for May of the next year, at the lower price in order to maintain a balance between his short position and his long position.

Since the taxpayer now has a contract to buy at a lower price than his contract to sell, he has locked in the gain on his short position. This gain is about equal to the loss in the leg he sold. The following year, the position is closed out and the gain realized.

The taxpayer, through these transactions, claims to have realized a loss in the first year and a gain the second year. This deferral technique may be repeated year after year in an attempt to claim an indefinite deferral.

It should be noted that although many of the transactions that have been promoted for tax avoidance have used nonagricultural commodities, precious metals and certain debt instruments, they all could be attempted using agricultural commodities.

Other commodities transactions are used in an attempt to convert ordinary income into a long-term capital gain either in the current year or deferred until the subsequent year. These transactions are particularly attractive because many more taxpayers wish to shelter ordinary income and because the purported tax benefit consists of an actual tax reduction as well as tax deferral.

In some cases, these transactions are based upon a provision in the tax laws which treats short-term Treasury bills as ordinary assets, not capital assets, even if held for investment.

In other cases, the taxpayer claims an ordinary deduction for the carrying costs of a commodity position and a capital gain on the sale of the commodity in the subsequent year, even though the gain on the commodity is nothing more than the buyer's indirect payment of carrying costs.

It is clear to us that transactions such as these are wholly tax-motivated and without any real economic substance. Literature promoting these transactions confirms that their purpose is to produce tax losses with little or no economic risk. Fees and commissions are often based on the size of the tax loss and not on the amount of assets purchased or sold.

Often, the taxpayer has little or no understanding of the underlying transactions other than their promise to produce a tax benefit. Moreover, no significant amount of cash need be advanced, since margin requirements are minimal where the "investor" holds both sides of the transaction. The minimal margin requirements for these types of transactions is another indication that these transactions are virtually devoid of risk.

We have published several revenue rulings involving tax-motivated commodities transactions. In 1977, we published a ruling disallowing the deduction of artificial losses in a series of transactions similar to those I described in silver future contracts. We found that the taxpayer's dominant purpose for engaging in the transactions was to offset a substantial gain from the sale of real estate.

The risk of silver transactions was limited because the taxpayer consistently maintained a "spread" position. That is he was consistently on both sides of the transaction.

The margin requirement to finance the purchase and short sales amounts to one-fourth of 1 percent of the total futures contracts purchased, was one indication of the limited risk involved. We concluded that the taxpayer had no reasonable expectation of deriving an economic profit from the transactions, apart from tax losses which we held would be disallowed. In 1978 we published a ruling applying the rationale of the 1977 ruling to a "spread" transaction in commodity futures contracts on Treasury bills.

Mr. **Rosenthal**. Let me interrupt, and I have already read the next paragraph but, in addition to publishing the rulings, are you aggressively reviewing the filings of individuals who have made those claims?

Mr. **Kurtz**. Yes; I can give you more detail if you would like. As I say in the next paragraph, we are now studying a number of transactions involving tax shelter commodity transactions. Additional rulings will be issued where warranted.

[The information follows:]

Commodity Options and Futures

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710 (5-30-80) 4236
Background

(1) Commodity options (options) and future delivery contracts (futures) tax shelter arrangements have been marketed, with increasing success, to high income taxpayers. The distinction between options contracts and futures contracts has been of importance from a tax standpoint because options contracts are covered by IRC 1234, while futures contracts are not. These tax shelters frequently use silver as the principal commodity, but the techniques are equally applicable to other commodities; e.g., tax shelters involving the use of interest rate futures (in Treasury Bills and GNMA Certificates) are being seen with increasing frequency.

(2) Each of these shelter arrangements involve buy/sell transactions which are balanced because, as the underlying commodity market price moves up or down, one part of the transaction (leg) becomes more valuable, while the remaining part (the other leg) becomes less valuable in approximately the same proportion.

(3) These tax shelters generally have little or no expectation of profit or loss, although they do entail actual market purchases and sales. Instead they are designed to artificially reduce and/or defer a tax liability by producing tax gains or losses that do not reflect economic realities. An example of their use is to convert short-term capital gain or ordinary income in one year into long term capital gain in another.

(4) The following basic tax shelter arrangements have been employed by taxpayers.

(a) The simultaneous buying and selling of futures contracts in silver, Treasury Bills or GNMA Certificates, or other commodities (often called "spreads", "straddles" or "tax straddles").

(b) The simultaneous purchase of spot commodities by use of highly leveraged (usually nonrecourse) financing and sale of a futures contract for the same commodity in a like amount (usually referred to as a "cash and carry" transaction).

(c) The use of option contracts to buy and sell silver, or other commodities (often called an option "straddle" or "spread").

(d) The purchase of a commodity (using conventional financing) and a related sale of a futures contract in the same commodity for a like amount (hedging). (Note: Although hedging transactions are sometimes used as components of tax shelters they are also frequently used by commodity users as a form of price insurance. *See* Rev. Rul. 72-179, 1972-1 C.B.57).

(5) A glossary of terms used in commodity transactions is included in Exhibit 700-1.

720 (5-30-80) 4236
Commodity Transactions

(1) Some straddles are entered into with an anticipation of making a profit. These straddles involve a degree of market risk which can result in a loss. Usually, this type of straddle will consist of two contracts, a buy and a sell with different delivery months, which are simultaneously entered into and closed. The price differential between the buy and sell is known as the spread from which profit or loss is determined.

(2) Tax straddles are more complicated than profit-motivated straddles and involve several straddles which are clustered and usually extend beyond one tax year. The employment of several straddles provides protection against changes in the price of the commodity or the spread, the price differential between delivery dates.

721 (5-30-80) 4236
Futures Straddle Tax Shelters

(1) One form of a straddle shelter (butterfly spread) is described in Rev. Rul. 77-185, 1977-1 C.B. 48. Frequently, more than one account is used in completing the entire series of transactions. On larger schemes, several dealers may be involved for the purpose of disguising the balanced nature of the transactions. One account will have the loss futures, another the gain futures, or one dealer will have the buy futures, another dealer the sell futures in the same quantity that comprises the other half of the balanced transactions.

(2) A balanced transaction in futures will be initiated some time before the end of the tax year. The losing portion of the straddle will be closed out in order to claim a loss, with the simultaneous re-establishment of an identical buy or sell with a different contract month. In the following tax year, the balanced transaction will be closed out after the six-month holding period resulting in a net capital gain (See IRC 1222(11). Section 1402 of the Tax Reform Act of 1976

retained the 6 month holding period for futures transactions) Note that it is the Service's position that as there is no "closed and completed transaction" until all transactions are closed out, the loss of the first "leg" of the straddle would not be allowed in the first year, but rather would be carried over and netted against the gain resulting from the second "leg" of the straddle in a subsequent year.

722 (5-30-80) **4236**

Options Tax Shelters

(1) Paired straddle arrangements in options were used either to convert capital loss to ordinary loss in one tax year or to convert ordinary income into short-term capital gain in a subsequent year (which then could be converted into long-term capital gain by use of a "commodities spread," as described in Rev. Rul. 77-185). For example, if a taxpayer had a significant capital loss, or loss carryover, from an unrelated transaction, the paired straddle arrangement was used to convert the loss to ordinary loss by grouping the transactions in one tax year. Alternatively, the paired straddle could be used to convert ordinary income from other sources into capital gain by spreading the transactions over two tax years. It should be noted, however, that these shelters are of little effect after the effective date of the Tax Reform Act of 1976 which amended section 1234(b)(1) of the Code. Prior to September 1, 1976, granted options could give rise to ordinary loss under certain circumstances; options granted after that date can give rise only to short-term capital gain or loss. Thus, the tax shelter described in paragraph 2 is effective only if the loss "leg" is based on an option granted prior to September 1, 1976 (although the option can be closed out at a later date).

(2) This arrangement was used by U.S. taxpayers who had American commodity dealers as intermediaries between themselves and London commodity dealers.

(a) The arrangement was initiated with a payment to the American dealer who used the monies to establish a "discretionary margin account" with the London dealer. The discretionary margin account agreement usually provided for the London dealer to have complete control and discretion over trading done in the account.

1 Under the rules of the London Metal Exchange, the holder of an option can exercise the option only on a given date referred to as the "expiration date." This is unlike the typical American option that can be exercised at any time. This factor is important because it prevents the holder of the option from exercising it before the grantor has accomplished the grantor's tax purposes.

(b) The "paired straddle arrangement" scheme consisted of several transactions involving the granting and purchasing of options of like quantity. For example, the taxpayer entered into four transactions on January 2, 1976, when *y* ounces of silver sold for 7.5*x* dollars. The premium paid or received for each transaction was 3*x* dollars. The four transactions were as follows:

1 *Transaction 1*—granting a call option with a prompt date of October 1, 1976, to sell *y* ounces of silver for 5*x* dollars.

2 *Transaction 2*—purchasing a call option with a prompt date of November 1, 1976 to buy *y* ounces of silver for 5*x* dollars.

3 *Transaction 3*—granting a put option with a prompt date of October 1, 1976, to buy *y* ounces of silver for 10*x* dollars.

4 *Transaction 4*—purchasing a put option with a prompt date of November 1, 1976, to sell *y* ounces of silver for 10*x* dollars.

(c) On September 30, 1976, when *y* ounces of silver sold for 9*x* dollars, the taxpayer closed out *Transaction 1* for 4*x* dollars (difference between 9*x* fair market value and 5*x* call price), sold the call option in *Transaction 2* for 4*x* dollars, and sold the put option in *Transaction 4* for 1*x* dollar (difference between the 10*x* put price and 9*x* fair market value). On October 1, 1976, the holder of the put option in *Transaction 3*, sold the silver to the taxpayer for 10*x* dollars who immediately sold it for 9*x* dollars, its fair market value on that date.

(d) The respective results of these four transactions are summarized as follows:

1 *Transaction 1*—1*x* dollars ordinary loss (difference between 4*x* dollars paid to close out the call and 3*x* dollars premium received to grant the call). See Rev. Rul. 78-181, 1978-1 C.B. 261.

2 In *Transaction 2*—1*x* dollars long-term capital gain (4*x* dollars selling price minus 3*x* dollars premium paid for the call option). See IRC 1234(a).

3 *Transaction 3*—2x dollars short-term capital gain on the silver sold (9x dollars amount realized minus basis of 7x dollars (10x dollars exercise price minus premium received of 3x dollars)).

4 *Transaction 4*—the taxpayer claimed 2x dollars long-term capital loss (3x dollars premium paid for the option minus 1x dollars received on its sale).

5 The net results of all four transactions are 1x dollars ordinary loss and 1x dollars short-term capital gain.

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Variations of the Basic Tax Shelters

(1) The basic component of the London Options tax shelters was the fact that the loss "leg" produced ordinary loss. Although section 1234 has been amended to preclude the use of options transactions to produce ordinary loss, such results may be achieved through the use of interest rate futures transactions. Under IRC 1221(5), transactions in Treasury Bills produce ordinary income or loss. Although it is current Service position that Treasury Bills futures are capital assets, transactions are currently being structured so that the loss "leg" is closed out by taking delivery and subsequently selling the actual Treasury Bill. This transaction, combined with trades in GNMA futures on the gain "leg" (as both Treasury Bills futures and GNMA futures are ultimately based on the same interest factors, a transaction in one type or contract can be used to "hedge" the other) achieves the result of producing ordinary loss balanced by a capital gain at little or no economic cost to the taxpayer.

(2) A variation of the basic option scheme involves transactions conducted through a Bermuda company. The scheme differs in the following manner:

(a) The options, *i.e.*, a granted put balanced by a taken put or a granted call by a taken call, are "hedged" by futures.

(b) The opening futures straddle is not closed out or "switched" as described in Rev. Rul. 77-185.

(3) A simple variant of the type of "straddle" described in Rev. Rul. 77-185 involves the purchase with borrowed funds (usually on a nonrecourse basis) of "spot" silver combined with a six to twelve month's futures contract to deliver an equal quantity. This scheme is sometimes referred to as the "cash and carry" silver shelter.

(a) The futures contract "hedges" the transaction and reduces the risk.

(b) Since the purchase and loan arrangement probably preclude actual delivery of the spot silver until the loan is paid, or the futures contract closed against the delivery obligation of the seller, the purchase of the spot silver and payment of interest appear to be part of a package arrangement undertaken solely or primarily to convert ordinary income into capital gain by claiming an interest deduction in the initial year and an offsetting capital gain in the subsequent year.

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Issue Identification

(1) Tax shelter transactions involving commodity straddles can be found on all types of income tax returns, divided between various returns, or scattered throughout different parts of the same return. They may involve different investment houses or different commodities. Therefore, care should be taken to examine all the commodity transactions of a taxpayer and then match them. It is not uncommon to find part of a tax avoidance scheme reported on a partnership return and part on the income tax return of each partner.

(2) Examples of how these transactions may be reflected on tax returns:

(a) An ordinary loss may be reported on Form 4797 (Supplemental Schedule of Gains and Losses), as "miscellaneous income," or on Schedule C (Profit or (Loss) from Business or Professions), or as other income on Form 1040.

(b) Capital gains and losses may be reported on Schedule D (Capital Gains and Losses).

(3) Schedule D indicators of possible tax shelter commodity schemes are:

(a) Transactions reported with a commodity or option as "kind of property and description."

(b) Transactions with no description given (particularly *short-term* gains or losses).

(c) Transactions with an ambiguous description and the date sold is *prior* to the date acquired.

(d) Ordinary losses from options with almost equal offsetting capital gains.

(4) Since gains and losses may be reported in different years, inspection of prior and subse-

quent year tax returns is essential in determining the extent of possible shelter schemes when commodity transactions are indicated during an examination.

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(1) Economic Reality of Commodity Transactions

(a) To be entitled to the loss deduction provided by IRC 165(c)(2), an individual investor, not in the commodity trade or business, has the burden of demonstrating that the options and futures transactions were entered into for profit. Evidence to establish the taxpayer's profit expectations can be broken down into at least two major areas of consideration:

1 Evidence that the taxpayer truly intended to profit from the transactions.

2 Evidence that the taxpayer had the potential for a profit from the transactions.

(b) I.T. Regs. 1.165-1(b) provides that the substance of *transactions* (not necessarily one transaction) will be determinative over mere form in the deductibility of losses. When one part of a straddle is closed out and simultaneously reopened (differing only in the commodity delivery date), the taxpayer's economic position has not changed sufficiently to establish that the transaction is for profit, rather than to obtain a tax loss, or that there is a closed and completed transaction for tax purposes.

(2) Deductions for Out-of-Pocket Expenses for Commodity Transactions

(a) In accordance with Rev. Rul. 77-185, when a determination is made that the taxpayer's dominant motive was not profit from the commodity arrangement but only to reduce income tax liability, no deduction for out-of-pocket expenses will be allowed under the provisions of IRC 165(c)(2).

(3) Ordinary Loss Deduction From Commodity Transactions

(a) Rev. Rul. 78-181 provides, in part, that ordinary gain or loss will be recognized when a taxpayer repurchases an option granted prior to September 2, 1976 from the option holder before the option life expires. September 2, 1976, is the effective date of IRC 1234(b) which provides that with respect to the grantor of an option all commodity option closing transactions will be treated as gain or loss from the sale or exchange of a short-term capital asset. A closing transaction is defined as any termination of the taxpayer's obligation under the commodity option other than through the exercise or lapse of the option. Commodity dealers are specifically exempted from the provision of IRC 1234(b).

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(1) Examiners should be aware that only part of a series of interrelated commodity transactions may be reflected on the return. Examination of the entire commodity account, or related accounts, covering a period of at least two tax years, may be necessary to determine if a tax shelter scheme is present.

(2) Examiners should secure documentation which includes the following:

(a) All contractual agreements between the taxpayer and the dealer.

(b) Records of all funds paid to and received from the dealer.

(c) All transaction confirmation documents issued for all commodity accounts.

(d) All transaction summary documents issued by the dealer.

(e) All monthly statements of account for all commodity accounts.

(f) Any correspondence between the taxpayer and the dealer which relates to the commodity accounts.

(3) Arrange the transaction confirmation documents in chronological transaction date order. Pair up the transactions in like quantity buy/sell or sell/buy order to facilitate understanding the sequence of transactions.

(4) Each balanced transaction pair can be compared to commodity market price quotations. The quotations include opening prices, high, low, and closing prices for each contract month traded. Compute the spread for all four quotations for the contract months involved to determine the range of the spread. If the spread for the contract month on the dealer confirmation slips is outside the range of the quotation spread computed, the presumption would be that the dealer determines the gain or loss from transactions and not the market. If this is the case, arguments presented by the taxpayer about profit and risk potential would have little or no merit for purposes of IRC 165(c)(2).

(5) The London Exchange

(a) The London dealers buy and sell only to themselves, on behalf of the taxpayer, in various commodity transactions. This is accomplished by the U.S. taxpayer establishing a "discretionary margin account" with a London commodity dealer. Due to the lack of arm's-length trading, it is important to determine whether a prudent investor would engage in option and futures transactions and reach the same economic and income tax result.

(b) Examiners should consider the following when reviewing the discretionary margin account agreement:

1 Determine whether the investors payment is a margin deposit or a commission.

2 Determine whether this type of agreement is used in bona fide trades (spot, future, and option) or is used solely for tax shelters.

3 Determine whether the London dealer has complete discretion as to price and time for trading.

(c) Examination of the trading account itself is recommended. It is possible for one taxpayer to have several commodity accounts. It is also possible for one commodity account to be shared by numerous taxpayers. Concentrating on the examination of the trading account should reduce confusion.

(d) A debit/credit analysis of the option and futures transactions trading account can be made on a transaction day-by-day basis. Option granting premiums received, futures sold, and any taxpayer investments are credits. Options taken, futures purchased, and commissions charged are debits. On any day that a net debit balance results in this analysis, the inference is that the London dealer is advancing funds to the taxpayer's trading account. If so, this is a situation where the London dealer is at risk rather than the taxpayer.

(e) Determine exactly what the margin requirements are. It may be possible that there is no margin requirement imposed on the taxpayer by the London dealer. However, inquiry should be made as to why a margin call by the London dealer was not made when the debit balance occurred.

(6) Examiners should, at a minimum, obtain information from the taxpayer with respect to the following areas.

(a) Establishment of the commodity account—Analyze information provided by the taxpayer on why specific commodity transactions were selected for investment. Consideration should be given to the taxpayer's knowledge and prior experience with commodities.

(b) Management of the commodity account—Determine whether the account is managed in total by the taxpayer's agent. Determine the type of input the taxpayer has with respect to decisions to be made.

(c) Cost—Determine the costs for the commodity account. Determine the type of payment required, i.e. commission, margin, or other fees. Determine whether there are any stipulations that the taxpayer will absorb additional loss or risk in any transactions and whether guarantees are offered by the agent.

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Information Sources

(1) *Metals Week Price Handbook* is issued each year with daily price quotations for the entire year on most metal commodities traded in the world.

(2) The *London Times* reports price quotations and market activity for all London commodities on a daily basis.

(3) The *Journal of Commerce* reports price quotations and market activity for all commodity transactions on a daily basis.

(4) The *Wall Street Journal* reports limited price quotations for London commodities and extensive U.S. commodity market prices on a daily basis. Silver prices are reported only from the London Silver Market.

(5) Additional information is available on the London Metal Exchange and London commodities in *The London Metal Exchange—A Commodity Market*, by Robert Gibson-Jarvie, published by Woodhead-Faulkner Ltd., in 1976, and *Getting Started in London Commodities*, second edition by the editor C.W.J. Granger, published by Investor Publications, Inc., in 1975 and revised in 1977.

Exhibit 700-1

Glossary

Account Sale—A statement by a broker to a commodity customer when a futures transaction is closed out. Sometimes referred to as a P & S (Purchase and Sale Statement) it shows the net profit or loss on the transaction with commission and other proper changes set forth and taken into account.

Backwardation—A London term used when an earlier delivery date of a particular commodity is priced higher than a later delivery date of the same commodity. This is the opposite of a contango.

Balanced Transaction—Any form of simultaneous commodity transactions that have one like quantity transaction becoming more valuable while the other like quantity transaction becomes less valuable as the underlying commodity market price is increasing or decreasing. This term includes any futures spread or option straddle transactions.

Basis—The difference between the spot or cash price of a commodity and the futures price of the same or related commodity, usually computed to the near future.

Bear Straddle—A commodity transaction where the "sell" month of the straddle comes before the "buy" month.

Bucketing—Directly or indirectly taking the opposite side of a customer's order into the handling broker's own account into an account in which the broker has an interest, without execution on an exchange.

Bull Straddle—A commodity transaction where the "buy" month of the straddle comes before the "sell" month.

Butterfly Spread—A special form of a futures spread involving double balanced transactions, rather than single, which are practically mirror images of each other. For example: Buy 21 March; sell 21 July; and buy 21 December; sell 21 July. The purpose is to minimize the possibility of gains or losses from changes in the futures transactions spread.

Call—An option contract giving the buyer the right to buy a commodity for a specific price within a specific time. Call options tend to become more valuable as the market price of the underlying commodity increases.

Commodity Option—A right, usually purchased, to buy or sell a commodity at a specific price within a specific time, regardless of the market price of the underlying commodity.

Commodity options are created, and sold, by the grantor. Purchasers are referred to as holders or takers. See also Call, Put, and Option Writing.

Contango—A term used when the later delivery date of a particular commodity is priced higher than an earlier delivery date of the same commodity. The difference in price represents a prepayment of interest and commodity handling charges. The opposite of backwardation.

Declaration Date—The last date on which the holder has the right to exercise the option. If the buyer fails to declare by such date, the option automatically expires. The declaration date is on the contract. Also called the *expiration date*.

Delivery Month—The month when delivery of the underlying commodity is contemplated by the parties to a future.

Discretionary Account—Term used to describe a special account in which the holder of the account gives written power of attorney to someone else, often his broker, to buy and sell without prior approval of the holder; often referred to as the "managed account" or Controlled Account.

Exercise Price—The contract price for which a future will be bought or sold if and when an option is exercised by an option holder. Also called the "striking price."

Expiration Date—The date on which an option contract expires; the last day on which an option can be exercised.

Financial Instruments—Currency, securities, and indices of their value. Examples include shares, mortgages, commercial paper and Treasury bills and bonds.

Futures—Any bilateral contract which specifies a delivery of the commodity at any date in the future after the transaction date. Normally, it specifies a minimum of 3 months to a maximum of 15 months. Sometimes termed a futures contract.

G.N.M.A.—Pass through mortgage-backed certificates guaranteed by the Government National Mortgage Association (GNMA or Ginnie Mae). The certificates are backed by pools of FHA insured and/or VA guaranteed residential mortgages, with the mortgage and note held in safekeeping by a custodial financial institution.

Exhibit 700-1 Cont.

Glossary

Grantor—The creator or seller of an option. Also referred to as an option writer.

Hedging—Taking a position in a futures market opposite to a position held in the cash market to minimize the risk of financial loss from an adverse price change; a purchase or sale of futures as a temporary substitute for a cash transaction that will occur later.

Interest Rate Futures—Futures contracts traded on commodities such as GNMA's, issuances of the U.S. Treasury, or commercial paper, the value of which is determined by yield. Currency is excluded from this category, even though interest rates are a factor in currency values.

Leg—One side of a balanced transaction. Also see Long Position and Short Position.

Long Position—The portion of a balanced transaction in futures that is initiated by the purchase of a future. A long position is terminated by an offsetting sale or by taking delivery of the underlying commodity.

Lot—The unit of measure in which a commodity is traded on a commodity market. This can vary from market to market for the same commodity. For instance, one lot of London silver is 10,000 troy ozs., whereas one lot of New York silver is 5,000 troy ozs.

Option—A right on the part of one party, based on contract, to buy (call) or sell (put) something.

Option Writing—A phrase used by the Chicago Board of Options Exchange to describe the creation of a stock option in that exchange.

P & S (Purchase and Sale) Statement—A statement sent by a commission house to a customer when any part of a futures position is offset, showing the number of contracts involved, the prices at which the contracts were bought or sold, the gross profit or loss, the commission charges, the net profit or loss on the transactions, and the balance.

Parity—The term used to describe the intrinsic value of a call option when the market price of the commodity underlying the call option is *less* than the exercise price, but the market price plus the premium equals or exceeds the exercise price. Also, the term is used to describe the intrinsic value of a put option when the market price of the commodity underlying the put option is *more* than the exercise price, but the exercise price plus the premium equals or exceeds the market price.

Position—A term used to indicate the existence of an option or future. An option or future is initiated by opening a position and terminated by closing a position.

Prompt Date—Term for delivery date.

Put—An option to sell a commodity for a specific price within a specific time. Put options tend to become more valuable as the market price of the underlying commodity *decreases*.

Short Position—The portion of a balanced transaction in futures that is initiated by the sale of a future. A short position is terminated by an offsetting purchase or by making delivery of the underlying commodity.

Spot—The term for the actual commodity being delivered on the transaction date at the present price rather than a future delivery price.

Spread—The difference in the prices of futures contracts of the same commodity with different delivery dates.

Straddle—A term used for any form of offsetting commodity transactions such as:

(1) Like commodity futures in two different market places.

(2) Commodity options with different delivery dates.

Striking Price—See Exercise Price.

Taker—The purchaser or holder of an option contract.

Tax Straddle—A special form of balanced transactions in futures that includes a purported or claimed "closing out" of the loss leg in the current tax year to create short-term capital loss coupled with the reestablishment of a nearly identical leg and the simultaneous closing out of the balanced transactions positions in a subsequent tax year.

Treasury Bills—Short term U.S. government obligations. Treasury bills generally are issued with 13, 26 or 52 week maturities. They are sold at a discount from the face value at maturity. For example, a one-year Treasury bill worth $10,000 at maturity may sell for $9,600. The $400 difference is the discount; 4 percent ($400 divided by $9,600) is the yield.

Treasury Bonds—Medium or long term obligations of the U.S. government. If not callable, these bonds pay interest semi-annually until they are mature, at which time the principal and the final interest payment is paid to the investor. If they are callable, the Treasury can call the bond back in advance of maturity, paying accrued interest to the investor at that time. Until such time as the bond is called, the semi-annual interest is paid.

(Next page is 4236-143)

Mr. Kurtz. The Internal Revenue Service is working to prevent taxpayers from utilizing these purported tax benefits.

A number of new steps have recently been taken that will help the IRS identify returns claiming losses from these transactions. Beginning with returns for 1979, audit coverage is determined by total positive income, the total income of the taxpayer before adjustments or deductions.

Under the former adjusted gross income concept, tax returns that had very large amounts of gross income but that had significant offsetting deductions, including deductions from certain tax shelters, would have a low AGI, and thus would have relatively low audit coverage.

Another new step is that tax return classifiers and screeners who help select returns for audit, that is, those people that actually look at the returns to determine which ones will be audited, are being instructed in how to identify those returns involving tax-motivated commodity transactions.

A third new step now being taken will provide our agents with additional audit techniques to identify and analyze tax sheltered commodity transactions on audit. We have also established liaison with the Commodity Futures Trading Commission which will make certain information and assistance available.

Mr. Rosenthal. Will you tell us what that is, more specifically?

Mr. Kurtz. Yes.

In conclusion, it is our view that these tax-motivated commodity transactions have little or no economic substance and should therefore be given no tax effect. We are continuing to examine tax-motivated transactions in order to discourage taxpayers from attempting to avoid their share of the tax burden.

Our efforts have progressed to the point where taxpayers claiming tax benefits from these transactions will face a substantial likelihood of having their returns selected for audit and their claims of artificial losses disallowed on examination.

That concludes my prepared statement, Mr. Chairman.

Mr. Rosenthal. I want to go to Commissioner Kurtz first.

Can you tell us the nature and character of the liaison you are setting up with the CFTC?

Mr. Kurtz. We have liaison with them here in Washington. We have discussed available information that they have concerning——

Mr. Rosenthal. Commissioner, let me tell you, I find them very hard to liaison with.

Can you tell us who you are liaisoning with and what the character of your arrangement is?

Mr. Kurtz. There are several things going on.

Mr. Rosenthal. How do you find them in terms of 1 to 10 on the spirit of cooperation?

Mr. Kurtz. So far without assigning a number, we have found them to be cooperative and interested in the problems. They have conducted training sessions for some of our agents in the intricacies of those commodities transactions.

Some of the information which we can and have obtained from them involves various registration forms for brokerage dealers, sales representatives, advisers, various investigative files, and we had access to a large number of investigative files in New York, many of which developed into tax examinations which are now in process.

It is a continuing liaison both here and in New York.

Mr. **Rosenthal.** How are you dealing with the question of silver trading in London, and things of that nature?

Mr. **Kurtz.** The so-called London market cases were a particular brand of transaction which was very popular a couple of years ago. We have 113 London cases now docketed in the tax court; that is, they have been through examination, disallowed in the appeals process, and are now docketed in the tax court.

Other cases in the same category are heading for the tax court.

Jerold Cohen is Chief Counsel, and perhaps can say a word about when they might be coming to trial.

Mr. **Cohen.** We are attempting to schedule trials for this fall.

Mr. **Kurtz.** In the London transactions we had revenue agents who went to London and actually examined the market transactions on that side to develop these cases.

Mr. **Rosenthal.** Are you telling us that under all these IRS guidelines and changes in attitudes that the tax straddle won't work any more and the people won't be able to avoid taxes by using the tax straddle?

Mr. **Kurtz.** These are two different issues. One is whether we think we will win the cases and the other is whether taxpayers will continue to claim the transactions on tax returns.

As I say, they are two different issues. We see sales literature going out on these transactions pointing out that the IRS does not agree with the results being proposed but the promoters don't agree with the Internal Revenue Service. It is our view that many of the investors are still going into the transactions.

It is a very costly, time-consuming process to identify the returns, examine the returns, and litigate, if people choose to litigate.

The law in the area is not fully developed.

Mr. **Rosenthal.** The statutory law or the interpretative law of the courts?

Mr. **Kurtz.** The statutory law is what leaves it open to the courts to some extent. There is no clear, explicit statutory prohibition against certain types of transactions but, as a matter of general tax law, that is tax law developed by the courts which says when a transaction is wholly tax motivated and there is no economic substance, it won't hold up.

Mr. **Rosenthal.** Is there a need for change in the law?

Mr. **Kurtz.** A change in the law which would specifically prohibit these transactions would be helpful in the sense that taxpayers would not go into them. It is our experience that taxpayers will take very questionable positions but very few will flat out violate clear provisions in the law.

Mr. **Rosenthal.** In your opinion is there a need for a change in the law?

Mr. **Kurtz.** A change in the law would be very helpful, and it is something that we have been working on together with Treasury and others. But it is very difficult to formulate provisions which would cover these transactions and at the same time not significantly interfere with what are the real market transactions.

We are confident that it can be done. We have not gotten there yet.

Mr. **Rosenthal.** How long have you been working on it?

Mr. **Kurtz.** A couple of months.

Mr. **Rosenthal.** How much longer will it take?

Mr. **Kurtz.** As you know, I always hestitate to promise dates, but we are working on it. It is a very high priority item.

Mr. **Rosenthal.** It is a high priority.

Mr. **Kurtz.** Very high.

Mr. **Carswell.** In February Treasury called a meeting of the Federal Reserve, the SEC, the CFTC, the IRS, and anybody we thought had any interest or contact in this at all, and got them all in one room and said we were going to make this a priority, and since then we have had cooperation with all of the agencies involved.

Mr. **Rosenthal.** You started in February and this is now almost the end of May.

Mr. **Carswell.** That is the first interagency meeting on that subject that has ever been held, and that was held I believe toward the end of February.

Mr. **Kurtz.** That is my recollection.

Mr. **Rosenthal.** Do you have a timetable for conclusion, for a conclusion of your studies, recommendations? I mean you won't get anything passed by the Congress this year if you don't come foward.

Mr. **Kurtz.** On legislative recommendations, we are moving as quickly as we can, but the transactions come in a dazzling variety, I might say.

Mr. **Carswell.** You have to face the problem that these are important markets, and if we misdefine this situation so that we knock out legitimate hedging transactions, we will have commercial effects we don't intend to have, and in that sense this is complex. It is an area where the Service and our tax policy people have had to learn from the beginning.

Mr. **Rosenthal.** Their lawyers are better than your lawyers?

Mr. **Kurtz.** Whose lawyers?

Mr. **Rosenthal.** The other people's lawyers.

Mr. **Carswell.** They are working with a statute that now exists and we are trying to figure out how the statute could be amended to eliminate any doubt about this unique type of transaction.

Mr. **Rosenthal.** Does it take 6 months or 6 years to devise a statutory remedy for this problem?

Mr. **Kurtz.** It has not been 6 months, but in areas as complex as this, 6 months would not be an unreasonable amount of time. We know about certain actions which are occurring.

We also know and have enough experience to know if we were to draft the legislation which would cover the transactions, it would not be 24 hours before there would be a new variety of transactions to cover the same thing. Therefore, we are trying to draft legislation which gets to the underlying concepts and tries to define ways in which we can distinguish not just the transactions we know about but those that will develop tomorrow, how those transactions differ from real market transactions.

It is a very difficult undertaking, but I feel we are making progress.

Mr. ROSENTHAL. Mr. Carswell, you said on page 11 of your statement, "Treasury, Federal Reserve Board, and the SEC have formed a working group with the help of CFTC," and so on and so forth. The group has met several times.

Tell us with whom you have met, when, who the outside persons were, and what the status of this interagency group is.

Mr. CARSWELL. The status of the group is informal in the sense that it doesn't have a charter, but it grows out of an interagency group that we worked with, first in studying the Treasury futures markets 6 months ago and then currently studying the Ginnie Mae markets; that is, the markets for forwards in Ginnie Maes.

That has basically been a Treasury-SEC-Federal Reserve operation.

Mr. ROSENTHAL. Who were the outside persons, various persons outside the executive branch?

Mr. CARSWELL. Well, we have talked to people from industry who have come in.

Mr. ROSENTHAL. The commodities industry?

Mr. CARSWELL. Yes; the commodity futures; I made a speech to the Commodity Futures Industry Association and since then I have seen various people in that industry. We have talked with the organizers and the officials in charge of the New York Futures Exchange, which is supposed to open up in another couple of months.

We have talked to representatives of the other exchanges.

Mr. ROSENTHAL. Have you recommended to the President or anybody that there be a formal structure set up like, for instance, the banking examination council? Why are you still meeting so informally?

Mr. CARSWELL. We are trying to figure out how it ought to be structured, but the economic group of the President did consider this matter and decided an informal approach was appropriate until we were able to get a better fix on how it ought to come out.

Mr. ROSENTHAL. How long have you been working on the informal group?

Mr. CARSWELL. It depends on whether you want to go back to the start of the Treasury futures study. If you do, then 19 months, but on the whole area of futures transactions, I guess about 6 weeks.

Mr. ROSENTHAL. Is there any progress being made?

Mr. CARSWELL. Yes; I think there is.

Mr. ROSENTHAL. Tell us a little bit about the Federal Savings and Loan Insurance Corporation bailout of Ginnie Mae.

Mr. CARSWELL. I am afraid I don't know the specifics.

That is an illustration of a transaction that took place in the Ginnie Mae area, and it illustrates a problem in that industry.

Mr. ROSENTHAL. What is the problem in the industry?

Mr. CARSWELL. The basic facts are that in a number of situations over the past few years institutions have taken very exposed positions, I guess in part because they didn't understand the risks they were getting into.

Mr. ROSENTHAL. What kind of institutions?

Mr. CARSWELL. The one you are referring to, savings and loan institutions.

Mr. ROSENTHAL. The Charter Washington Federal, for example?

Mr. CARSWELL. Yes; and it has been an exposed position on Ginnie Mae futures, and when it had to complete the transactions it didn't have the resources, and that would have led to failure and the Federal Savings and Loan Insurance Corporation provided assistance to avoid a failure.

Mr. ROSENTHAL. Did they consult with you? Did the FSLIC consult with you before they did this?

Mr. CARSWELL. No; not on that occasion. I really don't know the details of that transaction. All I know is what I read in the newspaper, but it is an illustration of that market malfunctioning.

Mr. ROSENTHAL. When Mr. Volcker called that so-called emergency meeting on a Wednesday, were you the Treasury representative or was the Secretary of Treasury present?

Mr. CARSWELL. I can't remember exactly what the Secretary was doing but we were both there when the phone call came, and the Secretary was jammed up with a number of other things and it ended that I did it.

Mr. ROSENTHAL. How serious did you assess the situation as being?

Mr. CARSWELL. We didn't know, but with the prospect of the Nation's second largest brokerage firm failing, we would regard that as possibly an important event.

Mr. ROSENTHAL. Why?

Mr. CARSWELL. Well, because of the ripple effect that it might have had.

Mr. ROSENTHAL. Give us the worst case scenario.

Mr. CARSWELL. Well, when a brokerage firm fails, its customers are prevented from completing transactions that they have in process and they also for a period at least can't get their securities, and that may in turn impede other transactions or situations that they are involved in.

Now, when you have a retail house such as Bache that could have involved a very large number of people and a very large number of trades, the failure to complete those trades would have necessarily impacted other brokerage houses and other customers.

It is hard to be sure exactly how it would have all come out, because it would have depended on whether some of the fail-safes that have been built into the exchange system would have worked. The amounts involved were fairly large, very large when you get a brokerage house as big as Bache and hence it was not a matter we felt one could dismiss.

Mr. ROSENTHAL. Then you all went into action?

Mr. CARSWELL. It ended that we didn't; what we did was survey the whole thing very closely and work with everybody involved and try to assess whether it was necessary to take action, and in the end we didn't have to.

Mr. ROSENTHAL. In other words, if the situation had deteriorated it certainly would have been of primary concern to the Treasury Department?

Mr. CARSWELL. Absolutely.

Mr. ROSENTHAL. What bothers me is that in an April 9, 1980, memorandum authored by Mr. Read P. Dunn, who is one of the Commissioners of the Commodity Futures Trading Commission, he asserts in there that the Treasury Department showed no interest; well, I will read the whole paragraph:

"When a certain amount of congestion was observed in the silver futures market," and he is discussing events from September of 1979 to March 1980, and I quote:

> When a certain amount of congestion was observed in the silver futures markets, I called the Treasury Department and the Federal Reserve Board in September, 1979, to ascertain the nature and extent of their interest in the silver and gold markets, and to learn whether they monitored the futures or were particularly concerned about developments.
>
> At that time, I learned they considered silver just as another commodity and expected the prices would move up and down, as is the case with other commodities. They showed no particular interest in silver.

He makes the assertion on a number of other occasions in here, as a matter of fact, he pays credit to you; he says:

> The only person from either agency who ever expressed concern about the silver market was Robert Carswell of Treasury, and this was on March 31 in his 10:30 p.m. call regarding Bache's request to close the silver markets.

If Treasury had some concern or interest in these markets, why were they so lackadaisical about expressing it, if Mr. Dunn's assertions are correct?

Mr. CARSWELL. Well, let me say that Mr. Dunn is correct, Treasury does not regard itself as being particularly interested in the silver market as a silver market.

It is not a monetary commodity any longer for the United States and it is, therefore, simply a commodity.

Now, I don't know who Mr. Dunn talked to in September. The only occasion that we are aware of, of a formal communication between Treasury and the Commodity Futures Trading Commission, was the meeting with Under Secretary Solomon, which I mentioned in my statement.

Mr. ROSENTHAL. I find your statement a very thoughtful and responsive statement, and on page 5 when you said you met on March 26 and talked about this you said:

> I did this because of the general responsibility of the Treasury to keep abreast of matters that might have the potential of destabilizing the financial markets and to take action that might be appropriate.

I understand fully that Treasury did not have a primary interest in the silver market. However, if the silver market did destabilize the other financial markets, then you had a very real and a very serious and primary concern.

My question is, if Treasury had advanced notice and a warning, why didn't they act, if you know the answer to that question?

Mr. CARSWELL. I am not sure that we had any understanding, at least of that, that there was a brokerage house as large as Bache that was as exposed as Bache, nor did we know the extent of the Hunt's position.

Mr. ROSENTHAL. That is a Rip Van Winkle defense.

Mr. CARSWELL. It is the case, though.

Mr. ROSENTHAL. This Congress is entitled to know why you don't know about all of those things. Were you out of town?

Mr. **Carswell**. No; there is no regulatory structure that gives it to us. There is no way the Fed or us could have known what the aggregate bank credit and silver was. It has taken 2 months after the events to do it.

Mr. **Rosenthal**. The CFTC knew all along.

Mr. **Carswell**. Not the credit exposure.

Mr. **Rosenthal**. They knew in August. We have minutes of their meetings. They said the Hunts were playing monopoly with the silver market.

Mr. **Carswell**. I think they knew the position.

I don't think they knew the full extent of the credit.

Mr. **Rosenthal**. That means that nobody has the overview of what was going on.

Mr. **Carswell**. The Commodity Futures Trading Commission powers are not, in the sense that you are saying, an overview set of powers.

Mr. **Rosenthal**. Well, does anybody in this Government have that overview?

Mr. **Carswell**. No; not in these markets.

Mr. **Rosenthal**. What should be done? Should it be corrected?

Mr. **Carswell**. That is what we are trying to grapple with, or that is what we are grappling with now, and we would expect to be able to answer that question in the relatively near future.

Mr. **Rosenthal**. Who is on this informal working group?

Mr. **Carswell**. Treasury, Federal Reserve and SEC.

Chairman Volcker, myself, and Harold Williams are the ones who have met on four occasions so far and their staffs. The staffs of all of us have been working and they have been meeting. They met this week three times.

Mr. **Rosenthal**. Three times this week? Where do you meet?

Mr. **Carswell**. I think they met in the Treasury.

Mr. **Rosenthal**. You said you met three times?

Mr. **Carswell**. I am talking about the staff meetings.

Mr. **Rosenthal**. Oh, the staff meetings.

Mr. **Carswell**. The staffs were meeting and the principals were meeting. The principals met last Thursday.

Mr. **Rosenthal**. Is the Comptroller of the Currency investigating the banks that speculated in silver?

Mr. **Carswell**. The Comptroller of the Currency is pulling together all the information on that episode, yes.

Mr. **Rosenthal**. Are you aware that many banks gave loans for silver speculation, both to the Hunts and to others?

Mr. **Carswell**. I am.

Mr. **Rosenthal**. Do you know how heavy that role was, how significant it was?

Mr. **Carswell**. I know generally that, well, in fact Chairman Volcker said yesterday that it looked to him like at least a billion dollars worth of credit.

Mr. **Rosenthal**. Do you think that is an appropriate role for a federally chartered institution?

Mr. **Carswell**. It is clear in retrospect, too much credit was extended there.

Mr. **Rosenthal**. Are you aware that the banks took silver as collateral?

Mr. **Carswell**. I certainly am now. There may be situations where that is appropriate, but it would depend upon the purpose for which they took it.

Mr. **Rosenthal**. Do you think that is legal for a bank to do that?

Mr. **Carswell**. As far as I know it is legal.

Mr. **Rosenthal**. Does it raise any ethical questions?

Mr. **Carswell**. I can't think of any, but there may be an ethical question involved. It is not a very productive loan depending on what the proceeds are used for.

Mr. **Rosenthal**. Is any disciplinary action being taken against the banks that were involved in these enterprises?

Mr. **Carswell**. There would be if they violated any law. That would be included in the investigation that the Feds are now undertaking.

Mr. **Rosenthal**. You said on page 5 you have discussed this matter with the Comptroller of the Currency. How are they proceeding with the investigation?

Mr. **Carswell**. Diligently. They have a number of examiners and their chief examiner is in charge of the project, and I have talked to him on a half-dozen occasions in the last month. As far as I know, it is going just as diligently as they can make it go.

Mr. **Rosenthal**. On page 6 of your statement you said that all of this speculation contributed to inflation directly.

If that be the case, and I assume it is, it still adds to the question of why didn't our Government act more vigorously earlier on?

Mr. **Carswell**. I guess about all I can say is it is a highly complex problem, and how you get speculation out of a market which is very important, because those markets have to continue, and we can't destabilize them.

Mr. **Rosenthal**. The fact that it is complex is not an adequate defense in a highly sophisticated technological society.

Mr. **Carswell**. It takes us time to work it through. We didn't happen to have a panoply of experts in the U.S. Government on commodity markets. The regulation has been given to the CFTC in a limited way, and there does not exist in the executive branch a panoply of instant experts that can solve these problems. We are getting at it as rapidly as we can.

We believe it is very important, and we have been working toward those areas where we did have expertise first, and that is the Treasury area and the financial futures market.

Mr. **Rosenthal**. One of the options, one of the recommendations is moving CFTC under the aegis of Treasury.

Mr. **Carswell**. I don't think that is the way I would personally want to go, but we are considering every option that anybody has suggested.

It is probably a mistake to put a regulatory function in a department like the Treasury. Regulation, it seems to me, ought to be looked at as an impartial event that occurs under a statute that tells the regulator what to do.

Treasury necessarily has to get involved in a lot of policy issues, and as a regulator it would be under pressures for the same kind of reason Internal Revenue Service operates as independently as we can have it operate, so it is not subject to political pressures.

Mr. **Rosenthal**. Do you think a regulatory agency like CFTC has a quasi-judicial responsibility?

Mr. **Carswell**. It necessarily does.

Mr. **Rosenthal**. Do you think they ought to meet with individual citizens who are the subject of the regulation?

Mr. **Carswell**. Well, I think regulators have always had that kind of ethical problem, and I think most agencies, I don't know what CFTC does, but——

Mr. **Rosenthal**. Do the judges in our courts do that, meet with the client before they write the decisions?

Mr. **Carswell**. I hope, under the Canons of Judicial Ethics, that would not be proper.

Mr. **Rosenthal**. But it is OK with regulators?

Mr. **Carswell**. Some regulators have done that in the past, and others now have rules that say they will not have ex parte meetings. Some still do, I guess.

Mr. **Rosenthal**. Mr. Jeffries?

Mr. **Jeffries**. Thank you, Mr. Chairman.

It seems apparent to me as we go along that, based upon what the folks back home are saying and what I keep hearing, that the money really doesn't belong to any of us anymore. It seems to be more a question of what the Government is willing to let us keep.

I would be interested to know in a show of hands of the people here, how many have wondered why they can't keep more of what they earn for themselves? That is what is hitting all of America.

What we are hearing so much about right now is along that vein. Risk is commensurate with gain. It seems to me we have to expose ourselves to extraordinary risk in order to put extra money aside today. Otherwise we find out we are going to come up with a guaranteed loss if we rely on the safety of a bank account.

The safer we act the more loss we are going to have. Any of those who want to put any money aside for old age, the future, or investment, and decide to put it in the stock market, or in the commodity market, or just in a savings account, it seems that they are going to come up with a guaranteed loss because of inflation.

Now I see that some want to start withholding interest on savings accounts, and dividend income. This will assuredly cut down on capital formation and further create problems within our economy.

So the question really boils down to: How do you go about getting ahead anymore? How do you do it?

The Government causes inflation by spending more than it takes in. It seems to me that people are just trying to keep their heads above water. I don't believe it is the people out there who are causing inflation; it seems to me that if we could force the Government to get out of activities they don't seem to know much about, and let the people go ahead and produce, we might all be a lot better off.

More Government intervention seems to equal more inflation, and more regulation, and less freedom and more pain and consternation for the people. It equals less money that people are going to get for their labor and investment.

All we seem to be hearing now is that we need more regulation, and more rules. I just heard a little while ago that maybe we didn't

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have to intervene with Bache. They were able to maintain properly capitalized, and they were able to go on. Bache is still operating. I understand that they have made more money in the most recent quarter than they have for some time. Obviously they were not about to go broke.

We might ask ourselves how many banks and savings and loans have gone broke in the last 10 years? Couldn't overregulation possibly be part of that problem?

I want to ask the question: Has anybody considered that?

Mr. **Carswell.** I think that is something that we are very mindful of, and that is, I think, part of the point that I tried to make, that they were not overregulated in this situation. We did try to let the market work it out, and as it happened, the market did work it out. It was a close one. If the silver price had not moved in a favorable way on that Thursday and Friday, it would have been quite otherwise.

Bache itself asked us to intervene and regulate those markets, and we did not. You ought to understand that it was close. We turned down Bache; and when you get in one of those potential panic situations you will find the very people that one day say they don't want any regulation coming in and saying they want regulation, and that is exactly what happened in this, so it does happen.

It happened in this situation. It is a good illustration of exactly that point. The industry was coming in and asking us then to exercise regulatory powers, and we didn't. We did exactly what you suggested that we should do, which is try and let the market work.

Mr. **Jeffries.** I think it is very important that we make the point that the market did work properly. But I continue to be fascinated by the very frequent references to excessive speculation.

I wonder if anybody could really define the term; what is "excessive speculation" and what do you really mean by "excessive speculation"? How do you define it?

Mr. **Carswell.** I would suppose that, what just went on in the silver market is a pretty good illustration. I don't know whether you can write it up in a dictionary definition, but you certainly can recognize it. Any market that went from $12 to $50 and then came down again in a period of a year, it seems to me, is not operating in a very rational way, and that is what speculation is all about.

Mr. **Jeffries.** Would you consider that bellies might be a speculative trade?

Mr. **Carswell.** I don't follow that market.

Mr. **Jeffries.** Many people might consider it so; it fluctuates a lot. If we can't really define excessive speculation, how are we going to find out what a fair price is? Who are we going to ask for the fair price?

Mr. **Carswell.** That is what is involved in having markets operate in an orderly way. If markets are fouled by excessive credit and by motives to corner or to squeeze, you will not have price discovery.

What you will have is a market manipulation and a price that emerges that is not in any way related to the economic underpinning of the commodity there, and that risk exists in some markets and that is why we do have regulation and people looking at those markets.

I think that has been recognized for 100 years. It is certainly true that that can be overdone, and a market can be killed by overregulation and improper regulation just as it can be killed by over and excessive speculation.

You are seeing today in the silver market the results of what went on in the last 6 months. There is very little trading now in silver. Nobody wants to touch it, and with the result that the price discovery today in silver is doubtful, too. That market has been damaged.

Mr. **Jeffries**. You might answer for me then, if a dentist in Peoria or a bank in Missouri or an oil minister in Kuwait is willing to pay $40 an ounce for silver, isn't that a fair indication of demand? Doesn't that constitute the buy side of the market?

Why would they get into the silver market to start with?

What inspired them? Have you any ideas on that?

Mr. **Carswell**. I suppose they expected to gain.

Mr. **Jeffries**. Well, you expect to do that in investment, too, or a savings account.

Mr. **Carswell**. Well, you know what you are getting in a savings account.

Mr. **Jeffries**. A guaranteed loss today.

Mr. **Carswell**. It is not the same type of transaction.

Mr. **Jeffries**. People put it away for what reason, to make a gain. They hope to have more than they started out with.

Mr. **Carswell**. I suppose in a savings account you put it away for a rainy day; you know what you are getting.

Mr. **Jeffries**. It's a pretty rainy day today. If all of these various individuals are willing to pay something for silver or hogs or cattle or wheat, that must be what the market is; and if you have that diverse a group of people willing to pay, wouldn't you say that must be the market?

Mr. **Carswell**. That was the market on any particular day, that is right, but the overall question is whether what went on in that market is economically justifiable. Looking back now over 6 months it clearly was not.

Mr. **Jeffries**. It was not economically viable?

Mr. **Carswell**. Justifiable. Our system was put through something that, I take it, in retrospect was a dangerous situation, and I am not sure it is the kind of risk we want to take knowingly.

Mr. **Jeffries**. Well, then the reason people started to buy silver, you say, is because they expected to realize a gain; was there any reason for that? What was the underlying thought, that they might make a gain that exceeded their dollar's loss of purchasing power?

Mr. **Carswell**. You asked the Hunts that question here and they said that they didn't trust—I don't know, what did they say? The paper said that they didn't trust the currency, I guess, and they felt it was a better way to have their——

Mr. **Jeffries**. The Hunts weren't the only ones in the market.

Mr. **Carswell**. I don't believe they were.

Mr. **Jeffries**. It would be interesting to find out.

Mr. **Carswell**. You will get five answers from anybody that you ask; but in the end they all felt they would be improving their personal positions.

Mr. **Jeffries**. The Hunts explained it, and it has been said many times before, because of the problems that we have with our currency, people are trying to put their assets in something that might serve as a dependable store of value.

Isn't that what they said?

Mr. **Carswell**. I am sorry; I just wasn't here.

Mr. **Jeffries**. The point that I am making is that, because of our excessive spending in Government, many people thought they needed to put their money in markets where gains might at least neutralize the costs of inflation. Many people apparently had the idea that the place to go was the silver market—or the commodity markets in general.

It would seem that the underlying cause then of our whole problem might rest right here in Washington in that we refuse to live within our means and so cause inflation.

Might that be some of it?

Mr. **Carswell**. There is certainly a relationship between inflation and an unbalanced budget in Washington, and I think the President has made that very clear, and I am very happy to see that action of the Budget Committees in addressing that.

Mr. **Jeffries**. All right, sir. Thank you, Mr. Chairman.

Thank you.

Mr. **Rosenthal**. That is a very significant note on which to terminate that inquiry.

I think that you are moving along appropriately.

Can we put it in any kind of a time frame, the various inquiries that you make in terms of the tax responsibility, and you, Secretary Carswell, in terms of the interagency group?

When are they going to have some solid recommendations that we can take a look at?

Mr. **Carswell**. As far as the tax question goes, the only item where we have not completed a specific project is on a legislative recommendation. In all other areas we are moving ahead and identifying returns.

Mr. **Rosenthal**. Give an outside date that you could conceivably be held to as to when you will have a legislative——

Mr. **Kurtz**. No; it is not wholly within our control.

Mr. **Rosenthal**. You may have until December 31. It may work out that way.

Mr. **Kurtz**. I really do think that we are quite close to having something that is worth exposing.

Again, let me say, Mr. Chairman, that if there is draft legislation which is presented to one of the committees that may well not be the final word, even as to the form of that legislation.

We would expect to have comments on it and others who have wider familiarity or a variety of experiences to comment on that legislation. The point is to get an approach together and something that appears to be reasonable. We are quite close to that.

Mr. **Rosenthal**. You, Mr. Carswell, tell us when can we expect something concrete.

Mr. **Carswell**. I would hope we will have something this summer. I really don't think that we ought to be rushing into quick figures here. I think it is too important.

Mr. **Rosenthal**. I am in agreement.

How long does it take?

Mr. Carswell. Well, as I say, I hope we will have something this summer, and that is the schedule that we are shooting towards.

Unfortunately, those markets are very complicated and very different. Foreign exchange futures really raise problems that are rather different.

Mr. Rosenthal. How many banks do you know that the Comptroller is looking into in terms of the silver situation?

Mr. Carswell. I couldn't give you a number.

Mr. Rosenthal. Do you have any idea?

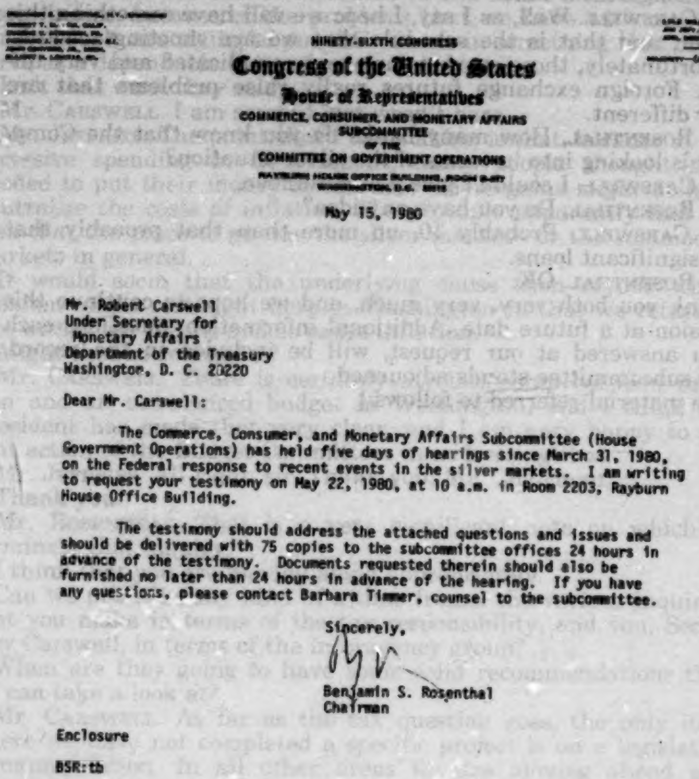
Mr. Carswell. Probably 10, no more than that probably that made significant loans.

Mr. Rosenthal. OK.

Thank you both very, very much, and we hope to continue this discussion at a future date. Additional information, questions each of you answered at our request, will be included in the record.

The subcommittee stands adjourned.

[The material referred to follows:]



NINETY-SIXTH CONGRESS
Congress of the United States
House of Representatives
COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

May 15, 1980

Mr. Robert Carswell
Under Secretary for
Monetary Affairs
Department of the Treasury
Washington, D. C. 20220

Dear Mr. Carswell:

The Commerce, Consumer, and Monetary Affairs Subcommittee (House Government Operations) has held five days of hearings since March 31, 1980, on the Federal response to recent events in the silver markets. I am writing to request your testimony on May 22, 1980, at 10 a.m. in Room 2203, Rayburn House Office Building.

The testimony should address the attached questions and issues and should be delivered with 75 copies to the subcommittee offices 24 hours in advance of the testimony. Documents requested therein should also be furnished no later than 24 hours in advance of the hearing. If you have any questions, please contact Barbara Timmer, counsel to the subcommittee.

Sincerely,

Benjamin S. Rosenthal
Chairman

Enclosure

BSR:tb

THE TREASURY DEPARTMENT AND FUTURES TRADING

ISSUES - May 22, 1980

I

The Role and Responsibility of the Treasury Department in the Silver Markets

Describe Treasury's general responsibility and authority for precious metals prices, markets and trading practices.

Does Treasury have a position with respect to the retention or disposition of the nation's silver reserve (approximately 139.5 million ounces transferred to the General Services Administration after 1970). Furnish all Treasury position papers, memorandums, correspondence, analyses and other documents relating to this issue, subsequent to January 1, 1979.

II

Speculation and Inflation

How does excessive speculation in any market add to inflationary pressures and expectations or have the potential to destabilize other markets?

How has speculative trading and rapid price increases in precious metals the last six months contributed specifically to inflation and inflationary expectations? Furnish all Treasury studies, analyses, position papers, etc., relative to this issue.

What international concerns were expressed about silver and the trading of other precious metals at the World Bank and International Monetary Fund meetings in Belgrade last fall? Furnish copies of any documents prepared for or resulting from this meeting relative to silver and other precious metals.

What present controls or regulations limit banks' speculative activities in currencies and precious metals? Furnish documents, guidelines, and working papers prepared for and resulting from bank examinations for both hedging and speculation.

III

Interagency Policies and Coordination

What specific authority does Treasury presently have or exercise under the Commodity Futures Trading Improvement Act of 1978?

What Treasury proposals for legislative or regulatory reform have resulted from or been enforced by recent events in the silver futures and related markets? Furnish copies of documents, studies, and position papers subsequent to January 1, 1979.

Please comment specifically on the attached GAO recommendations from May 1978, including increased authority for SEC and formal establishment of an inter-agency Council on Regulation of Securities Futures.

Describe Treasury's concerns over adequate disclosure requirements, margins, and other customer protections using as examples the request of the Kansas City Board of Trade (KCBT) to market a futures contract based on the Value Line Average, the proposed Chicago Mercantile Exchange's contract based on Standard and Poor's 500 stock index, and the 11 contracts proposed by the Chicago Board of Trade based on various selected industry group stocks.

IV

Financial Futures

What relationships are there among the financial futures markets and the cash markets for Treasury securities?

Describe the development and growth of Treasury bills and bonds, and Ginnie Mae futures contracts, including trading volume and open interests. To what extent are these markets used for short-term speculation in interest rate movements and relationships? How does speculative activity or tax-motivated trading impact adversely on Treasury's debt management responsibility?

What side effects, problems, uncertainties, or other contingencies is Treasury studying which may result from the explosive growth of financial futures? Discuss specifically the issues of proliferation, duplication, deliverable supplies, and the competitive devaluation of exchange self-regulation.

What problems with the GNMA forward markets have been identified? Summarize findings of the 1980 study conducted with the Federal Reserve and SEC. Furnish copies of documents and working papers prepared for and resulting from this study.

Answers to Specific Questions

I. THE ROLE AND RESPONSIBILITY OF TREASURY DEPARTMENT IN SILVER MARKETS

A. Describe Treasury's general responsibility and authority for precious metals prices, markets and trading practices.

The Treasury has no statutory responsibility for regulating the precious metals markets, or the prices and trading practices in those markets, nor does it have any authority with regard to futures trading in those markets.

However, as the custodian of the nation's gold stock and the Cabinet agency responsible for international monetary policy, Treasury closely and continuously monitors the markets for gold. Gold is of concern because of its role as a reserve asset. Though the United States no longer counts most of its gold stock in its international reserves and has been involved in an effort to demonetize the metal, many foreign countries still consider gold as part of their reserves. Consequently, gold is a commodity that still has important bearing in international monetary affairs.

As part of the demonetization effort, the Treasury has conducted a gold auction program since May 1978. Increased sales of gold to 1-1/2 million ounces monthly were part of the November 1978 dollar support measures. Treasury gold auctions were suspended in November 1979.

The Treasury did have direct interest in silver because of its monetary qualities, but since June 1968, silver certificates are no longer exchangeable for silver. Since 1970, some Treasury silver has been used in manufacture of silver clad coins--the latest were the coins in the bicentennial series of 1976. Most of the U.S. Government's silver is currently not owned by Treasury but by the General Services Administration as part of the Strategic Stockpile.

B. Does Treasury have a position with respect to the retention or disposition of the nation's silver reserve?

The Congress has not permitted the 139.5 million ounces of silver in the Strategic Stockpile to be sold even though it has been declared to be excess. 50 U.S.C. 98e states in part: "The President shall... subject to the notification required by subsection (d)(2) of this section, provide for the timely disposal of materials in the stockpile that (A) are excess to stockpile requirements, and

(B) may cause a loss to the Government if allowed to deteriorate." Since the silver is not in danger of deterioration, Congressional approval for sale is required. The President is authorized to sell materials in the stockpile for national defense purposes, but cannot do so on solely economic grounds. The Treasury does not have a position with respect to the retention or disposition of this silver.

II. SPECULATION AND INFLATION

A. How does speculation in any market add to inflationary pressures and expectations or have the potential to destabilize other markets?

Excessive speculation may add to inflationary pressures when that speculation translates into the demand for physical commodities as a store of value and as an investment. The demand for a commodity by non-users can add to the overall demand for that commodity and to increases in its price. Anticipatory purchases may also add to the pressures on prices. Higher prices get translated through the economic system and may result in higher prices for the commodities using such products. For example, in the precious metals area, silver is a key ingredient in the prices of the final products. When the price of silver declines it is unlikely that the prices of the products using silver will be reduced to the same extent that they were increased, since prices are not very flexible on the downward side. Precious metals accounted for about .5%

of the 1.6% increase in the Producer Price Index in January. Such increases not only feed through the production process and result in price increases which are not necessarily reduced when commodity prices go down, but also result in increases in wage and price contracts tied to the price indices, further exacerbating inflation.

B. How has speculative trading and rapid price increase in precious metals the last six months contributed specifically to inflation and inflationary expectations?

Although it is clear how the processes of speculative demand and anticipatory purchases can add to inflationary pressures, it is difficult to quantify specifically how such trading and the rapid increases in the prices of precious metals have added to inflation in the last six months. One would have to consider the entire production process and the relative contribution of all inputs to the final product and its ultimate price. The complexity of our economy makes such an analysis extremely difficult. It would be necessary to separate out each factor within the input process to determine legitimate price increases from those that may be attributed to speculative demand. We are not aware of how such a task could be carried out in specific terms, particularly since our economy has been subject to many sources of inflationary pressures during the past six months, including those that have come from the rapid increase in energy prices.

C. What international concerns were expressed about silver and the trading of other precious metals at the World Bank and International Monetary Fund meetings in Belgrade last Fall?

There was general concern expressed about markets for precious metals and currencies worldwide. Many attributed the high prices of gold and silver to speculative buying. Some bankers, in particular, believed that the high level of speculation on U.S. futures markets was due to low margin requirements.

D. What present controls or regulations limit banks' speculative activities in currencies and precious metals?

National banks are permitted to speculate in foreign currencies, but their speculative positions must be less than 5% of their capital. Major banks, moreover, are required to file weekly and monthly reports with the Treasury Department on their worldwide foreign currency positions. In addition, banks are required to have reasonable internal guidelines and procedures setting limits to the foreign currency positions they can take. As part of the examination process, bank examiners assure that the foreign currency reports are accurate and that internal guidelines and procedures are adequate.

There are no legislative limits on the speculative activities of banks in bullion, which includes gold and silver of a high degree of purity. Speculation in platinum or any other precious metal is not permitted. The bullion owned by a bank must be carried on its books at its market value. National bank activities in precious metals are specified in Office of the Comptroller Banking Circular 58.

National bank activity in futures is specified in Office of the Comptroller of the Currency Banking Circular 79, updated November 16, 1979. Banks are prohibited from using any futures market, including foreign currency and precious metals futures markets, for any purpose other than for hedging.

III. INTERAGENCY POLICIES AND COORDINATION

A. What specific authority does Treasury presently have or exercise under the Commodity Futures Trading Improvement Act of 1978?

The Futures Trading Act of 1978 (P.L. 95-405, September 30, 1978) provides that "The Commission shall maintain communications with the Department of the Treasury, the Board of Governors of the Federal Reserve System, and the Securities and Exchange Commission for the purpose of keeping such agencies fully informed of Commission activities that relate to the responsibilities of those agencies..." It further provides that the Commission shall solicit the views of the Department of the Treasury and the Board of Governors of the Federal Reserve System "when a board of trade applies for designation as a contract market involving transactions for future delivery of any security issued or guaranteed by the United States or any agency thereof..." and that "the Commission shall take into consideration all comments it receives and shall consider the effect that any such designation, suspension, revocation, or emergency action may have on the debt financing requirements of the United States Government and the continued efficiency and integrity of the underlying market for government securities."

B. What Treasury proposals for legislative or regulatory reform have resulted from or been enforced by recent events in the silver futures and related markets?

The Treasury is currently participating in a study of the need for legislative and regulatory reform arising out of the recent events in the silver futures and related markets with the Federal Reserve, the SEC, and the CPTC. It is expected that the study will lead to legislative or regulatory proposals.

C. Comment specifically on the attached GAO recommendations from May 1978, including increased authority for SEC and formal establishment of an interagency Council on Regulation of Securities Futures.

The May 1978 GAO Report recommends (1) that the SEC have the authority to "regulate all futures contracts on securities (and indexes thereon) subject to the registration requirements of the Securities Act of 1933," (2) that the SEC have "the right to bring enforcement action under section 17(a), 20, and 22 of the Securities Act of 1933" on futures contracts on unregistered or exempt securities, subject to CFTC's prior right to act" and (3) that an interagency council of the Treasury, the SEC, the CFTC, "and such other agencies as the President may designate be created as an advisory forum on financial futures."

There are currently no futures contracts on securities subject to the registration requirements of the Securities Act of 1933 or the indexes based on such securities. However, the Kansas City Board of Trade has a proposal for a futures contract on the Value Line Average. The GAO envisages that such a contract would be approved and regulated by the SEC. The SEC has argued, and the GAO agrees, that in order for the SEC to be fully effective in its regulation of the cash and options markets on these securities it must also have jurisdiction over futures in this area.

As far as government securities are concerned, the GAO does not argue that futures on these be regulated by the SEC. However, the SEC should have the power, according to the report, to bring enforcement action against fraud, with the CFTC, though, having the prior right to act.

The interagency council is to be set up to assure "the maintenance of continuous liaison and information exchange between and among its members for the purpose of promoting efficiency, coordination, and consistency in the formulation of overall Government policy." The council would advise the CFTC and the SEC.

The Treasury plans to address these issues in its current study of futures, forwards, options, and related financial markets.

D. Treasury's concerns over adequate disclosure requirements, margins, and other customer protections.

The Treasury's concerns over adequate disclosure requirements, margins, and other customer protections on stock index futures are described in its letter to the CFTC commenting on this contract (attached).

IV. FINANCIAL FUTURES

A. What relationships are there among the financial futures markets and the cash markets for Treasury securities?

There exists a close relationship between financial futures markets and the cash markets for Treasury securities because of the close substitutability of these investment alternatives. The return on an investment in each market must be similar, or traders, by arbitraging, will move to eliminate the discrepancy. If the futures price were to exceed the spot price by more than the financing costs involved, arbitrageurs would buy the security in the spot market and sell it in the futures market.

Price movements in the cash market can be transmitted to the corresponding futures market and vice versa. A major concern is what effect speculation in the Treasury bill futures market, for example, will have on prices in the Treasury bill cash market. At the present time there is no evidence that destabilizing speculation has taken place in the Treasury futures markets.

B. Describe the development and growth of Treasury bills and bonds, and Ginnie Mae futures contracts, including trading volume and open interests. To what extent are these markets used for short-term speculation in interest rate-movements and relationships? How does speculative activity or tax-motivated trading impact adversely on Treasury's debt management responsibility?

There are presently three major contracts being traded in Treasury futures securities. GNMA pass through certificates with a principal balance of $100,000 have been traded on the Chicago Board of Trade since October 1975. On the International Monetary Market of the Chicago Mercantile Exchange, $1,000,000 contracts in 3-month Treasury bills have been traded since January 1976. And in August 1977, the Chicago Board of Trade introduced a contract that calls for delivery of $100,000 par value of Treasury bonds having a maturity of at least 15 years.

The volume of trading in the three contracts has increased steadily since their introduction, although T-bill and GNMA futures experienced a temporary downturn in the first quarter of 1979, and GNMA trading volume was down slightly during the first quarter of 1980. In the period beginning in the first quarter of 1978 and ending in the first quarter of 1980, the number of T-bill futures contracts traded increased from 96,206 to 773,312. During the same period, GNMA contracts rose from 152,211 to 481,833, and T-bond contracts increased from 35,906 to 992,766. These are quarterly totals (See Table 1).

In the Treasury bill futures market, open interest peaked in the second quarter of 1979 and has been declining steadily, although it is still above early 1978 levels. Open interest in the GNMA and T-bond markets continued to rise during 1979 but fell sharply in the first quarter of 1980 (See Table 2).

Many transactions in these markets have been undertaken for speculative purposes. A 1979 CFTC survey estimated that noncommercial traders accounted for 81.7%, 72.6%, and 66.4%, respectively, of the open interest in the GNMA, T-bill, and T-bond contracts. These are the traders most likely to use the market for speculative and tax purposes.

Speculative activity can adversely affect Treasury's debt management responsibility to the extent that it disrupts the underlying cash market for Treasury securities. Destabilizing speculation would increase the price risk of Treasury securities, making investors less receptive to new issues and decreasing the liquidity of the important secondary market for Treasury securities. At this time, there is no evidence that destabilizing speculation activity has existed.

C. What side effects, problems, uncertainties, or other contingencies is Treasury studying which may result from the explosive growth of financial futures?

There are several problems which may arise as a result of the explosive growth of financial futures. One is the question of how the volume of trading in financial futures would be distributed among the various exchanges. In the case of duplicative contracts, it can be expected that many contracts will fail as business is channeled to the exchange that is expected to be most active and provide the greatest liquidity. Also, there is concern that proliferation of contracts would increase the potential for market manipulation either by increasing demand for deliveries or by reducing the effectiveness of the exchanges' surveillance of market activities.

The Treasury futures contracts now trading or proposed are all based on a presumption that supplies of cash market issues with requisite maturities will be readily available to meet any demands for delivery that may develop from market participants holding long positions in the futures. A concern is that pressure may be exerted on Treasury to increase the deliverable supply of a particular issue if the existing supply is too small and subject to manipulation in the market.

There is an added problem with contracts in Treasury notes because Treasury debt management tactics might change before the delivery date of a contract already trading. In this case, a much smaller supply of deliverable securities would be available than had originally been expected. Again, pressure might be exerted on the Treasury to modify its longer-run debt management objectives.

The possibility of competitive devaluation of self-regulatory standards exists if financial futures grow too rapidly. Margin and mark-to-market requirements are not uniform throughout the industry and incentives may exist to lower the requirements in order to increase business. Moreover, with increased competition among exchanges, brokers may not be as careful in making customers aware of the risks involved in futures trading.

D. What problems with the GNMA forward markets have been identified?

The 1980 Study on Government Guaranteed Securities and Related markets will soon be completed, and a copy will be sent to the Committee.

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

February 11, 1980

Dear Mr. Hanley:

I am pleased to respond to your letter of December 4, 1979 requesting comments by the Department of the Treasury on the proposal made by the Kansas City Board of Trade (KCBT) to market a futures contract based on the Value Line Average (VLA). We note that this proposal and the associated documentation demonstrate that the KCBT has expended considerable effort to improve its initial proposal in 1978. In particular, the shift to the more broadly based Value Line Average provides a measure of total stock market movement superior to the earlier proposal.

As we noted in our letter of November 9, 1978, we support developments that promote the efficiency of the nation's capital markets while providing effective protection of investors and minimizing the chance of market disruptions. Since our 1978 communication with the Commission, the marketplace and regulatory agencies have learned considerably more about financial futures. For example, in May 1979, the Federal Reserve/ Treasury study was completed, which included extensive interviews with market participants. Some of the concerns expressed in our earlier letter have been assuaged by experience and continued analysis of the issues involved. But other concerns still linger and, indeed, are reinforced by the press of events. Moreover, many now believe that approval of a stock index future will lead quickly to pressure for futures on narrow sectoral indices and individual stocks. Thus certain regulatory matters, particularly the authority to establish and adjust margins and the erection of adequate investor protection safeguards, should be settled prior to approval of even an index future. Therefore, although the specific KCBT proposal represents an improvement over its earlier submission, there remain important problems which need to be resolved before we would be satisfied by approval of the contract, particularly since this contract may attract substantial participation by individual investors.

Suitability and Other Customer Protection

First among our concerns is the likelihood that a stock index future such as the proposed VLA contract will be inappropriately merchandised by brokerage firms and improperly used by investors who do not fully understand these contracts. We envision the possibility that the stock index future could become, in these times of heightened speculative tendencies, a popular means for the uninformed to "bet" on the future course of stock prices. Clearly, if the contract gained broad public acceptance, the risk component of household portfolios would be increased greatly, but not necessarily with the appropriate appreciation of the potential consequences.

On equity grounds, and because well-publicized losses to small investors "taken for a ride" could potentially disrupt markets, various organizations have advocated customer suitability requirements for futures and/or options trading. The NASD, of course, requires its members to "know your customer" (both to protect the NASD member and the customer). Beyond that the SEC in 1967 adopted its own requirement for non-NASD dealers which imposes on securities firms an "affirmative duty" to inquire as to suitability to a particular transaction for a customer. The CBOE, when it began operations in 1973, adopted a rule similar to the SEC "affirmative duty" requirement. The joint Fed/Treasury study on financial futures in 1979 called for "further study of investor protection". And the SEC Options Study recommended that the broker/dealer be required to "find that the customer is capable of evaluating the risks" of options trading.

In response to the concern over adequate disclosure and customer suitability, the KCBT states that various "measures will be instituted to preclude the participation of the unknowing and the unwary". However, the KCBT proposal is not specific in defining these "measures". Indeed, while the KCBT rules require each FCM to have a written customer suitability program, no uniform minimum standards are specified. The eagerness to stimulate activity in stock futures is an incentive to minimize investor safeguards. Moreover, the competition between stock futures and stock options may lead to a "competition in laxity" with respect to those safeguards. Thus, it is important to have appropriate investor protection provisions in place prior to the designation of any stock futures contract. It should also be clear that the KCBT has the capability to enforce such protections, and that the CFTC has adequate authority and resources for discharging its oversight responsibilities.

Treasury also favors a more explicit and elaborate risk disclosure statement than that now required by CFTC's Rule 1.55. For example, in addition to the statement that "the risk of loss in trading future contracts can be substantial" and that the participant "... may sustain a total loss of ... initial margin funds ...", the statement might identify the percentage variation of a contract's price, or that of the underlying index, which would produce a loss of initial margin. The disclosure statement should also discuss the characteristics of the index and its historical behavior in different types of market environment, the nature of companies included in a narrow sectoral index, and the risk magnification effect of leverage. Also, data are available about the percentage of "nonprofessional" participants who typically lose on commodities futures trades and such data might be included in the disclosure to underline the message and enhance its educational value.

Proliferation of Contracts

The well-documented growth of futures and options attests to the instruments' marketability and broad acceptance. Whether or not the KCBT stock index proposal becomes a success, other exchanges are likely to follow suit with variations on the stock index future. Thus, our second concern is that this new market sector may burgeon far more rapidly than the resources of the Commission and the exchanges, leading to the possibility that oversight and surveillance capabilities will become strained if not insufficient.

Multiple exchanges dealing in various stock index futures and/or multiple listings of the same future on several exchanges are not onerous *per se*. Presumably, the most efficient quantity, quality and distribution of stock index futures contracts will be determined ultimately by the marketplace, with some contracts and even some exchanges falling by the wayside. However, during this playing out of the competitive process, proliferation will necessarily place new and difficult burdens on the surveillance staffs of the individual exchanges and on the oversight/surveillance resources of the Commission. We are especially concerned that minimum, uniform reporting standards be applied to the various exchanges and/or contracts so that manipulative practices could not be carried out on multiple exchanges to avoid detection.

Margin requirements

The size of the initial and maintenance margins on stock futures influences futures' competitive position vis-a-vis options. Of course, exchange-traded options exist only for some individual stocks; and the stock index future would not be in direct competition with the options market. However, if the CFTC approves individual stock futures on one or more stocks currently traded on the options market, either the stock future or the stock option might initially dominate the other, depending on a variety of factors. These factors include: the option price (premium), the size of the initial futures margin, the futures contract price, and options buyers' preference for limited down-side risk. Indeed it is evident that futures exchanges, in the current regulatory framework, could reduce margin requirements on individual stock futures low enough to obtain a competitive advantage over the options market (*i.e.*, a sufficiently low margin requirement could always cause futures contracts to dominate options purchases -- except for those investors who wished to limit down-side risk to the loss of the option premium).

In addition, margin requirements also serve a customer suitability and protection function. An appropriately high margin requirement would screen out certain investors whose sophistication and resources make them unsuitable customers for stock index and individual stock futures.

At present, apparently neither the CFTC nor any other agency has clear authority to establish and adjust margins for approved contracts, and thus could not stop ambitious futures exchanges from setting initial margins very low or even at zero (while still requiring daily, after the fact, marking-to-market). At a minimum, regulatory authority in this area should be specifically clarified or established. Obviously, there must be coordination among the CFTC, SEC and Fed to monitor competitive inequities as between stocks, stock options, and stock futures, brought on by margin regulation. It is our view that this aspect of the stock futures question should be resolved, through new legislation if necessary, before approval of any stock futures contracts.

Stock eligibility requirements.

To minimize the chances of corners or squeezes occurring, the Commission should consider eligibility standards for *individual* stocks traded under futures contracts. These would be intended to assure that the depth and liquidity of the spot market were sufficient to undercut any manipulative practices. That is, the Commission would have to set terms on the outstanding number of shares, yearly trading volume, etc. related to a particular stock in order for it to qualify, on a continuing basis, as the underlying issue for a stock futures contract. The CFTC should consider the relevance of standards used by the SEC in evaluating stocks for options trading. Also, the Commission would need to be prepared — with clear legal authority to do so — to close out trading in a particular contract if an emerging corner or squeeze was detected. Also, a cash delivery mechanism for an individual stock futures contract would not necessarily deter a corner or squeeze, or provide a solution to an emerging squeeze, since if the underlying issue were truly cornered it would be uncertain how a cash delivery price would be determined. These issues ought properly to be resolved prior to the approval of a contract based on an individual stock or narrow sectoral stock index.

In sum, although a stock index future could play a useful role in certain investment strategies, we are deeply concerned about the problems raised, particularly in the area of consumer protection and margin regulation. We think these problems must be resolved prior to your approval of trading in any stock future.

Sincerely,

Robert Carswell

Robert Carswell

Mr. John L. Manley
Director
Division of Trading and Markets
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D.C. 20581

TABLE 1

Treasury Futures Volume: Treasury Bills, GNMAs, and Treasury Bonds (number of contracts)

		GNMA**	
	T-Bill*	(CDR)	T-Bond**
1978:			
I	96,206	152,211	35,906
II	129,290	192,562	77,596
III	200,172	278,904	160,315
IV	343,412	329,484	281,533
1979:			
I	272,252	237,629	289,145
II	459,307	293,548	461,293
III	530,585	336,722	528,827
IV	668,338	503,179	780,329
1980:			
I	773,212	481,833	992,766

*IMM T-bill contract ($1 million per contract)
**CBOT,GNMA and T-bond contracts ($100,000 per contract)

TABLE 2

Treasury Futures Open Interest:

Treasury Bill, GNMA, and Treasury Bond Futures
(number of contracts)

	T-Bill*	GNMA** (CDR)	T-Bond**
1978:			
I	15,641	20,254	6,091
II	23,694	33,503	8,808
III	33,940	41,621	14,691
IV	59,208	62,722	41,246
1979:			
I	52,665	63,011	45,933
II	61,208	73,339	61,472
III	41,399	77,049	65,964
IV	36,495	88,982	90,676
1980:			
I	28,479	47,725	58,776

* IMM T-bill contract ($1 million per contract)
** CBOT, GNMA and T-bond contracts ($100,000 per contract)

[illegible]

[illegible]

NINETY-SIXTH CONGRESS
Congress of the United States
House of Representatives
COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

May 16, 1980

Hon. Jerome Kurtz
Commissioner
Internal Revenue Service
Washington, D. C. 20224

Dear Mr. Commissioner:

The Commerce, Consumer, and Monetary Affairs Subcommittee (House Government Operations) has held five days of hearings since March 31, 1980, on the Federal response to recent events in the silver markets. I am writing to request your testimony on May 22, 1980, at 10 a.m. in Room 2203, Rayburn House Office Building.

The testimony should address the attached questions and issues and should be delivered with 75 copies to the subcommittee offices 24 hours in advance of the testimony. Please furnish documents, analyses, studies or reports on present regulations or proposed revisions to IRS policy which would complete the hearing record. If you have any questions, please contact Barbara Timmer, counsel to the subcommittee.

Sincerely,

Benjamin S. Rosenthal
Chairman

Enclosures

BSR:tb

I. PRINCIPLES AND POLICY

Discuss the general principles for tax treatment of option or futures contracts and the closely related underlying commodities.

Are agricultural commodities and futures contracts treated any differently than financial instruments and the related futures contract?

Are hedgers in the futures and cash markets treated differently than speculators?

Discuss the specific provisions which apply to Treasury bill futures and the underlying instrument, and if they differ from the treatment of other financial instruments or agricultural commodities, the policy reasons or rationale for such differences.

II. DEFERRAL

Discuss methods used in futures trading to defer tax liabilities, including "straddles" and "spreads." What are any present or proposed restrictions on these techniques?

The "wash sale" rule disallows deduction for losses incurred if a trader enters into a "substantially similar" position for no economic purpose except tax avoidance. Discuss present application of and proposed changes in the wash sale rule for futures trading.

Has the IRS considered a simple mechanical year end wash sale rule which would prevent tax deferral without the difficult analysis of a taxpayer's motive or purpose? If IRS simply disallowed a deduction in one year where the futures trader carries an unrealized profit into the next in a similar position, wouldn't tax deferral be greatly minimized?

III. CONVERSION

What tax inducements are there for futures traders to actually take delivery of Treasury bills? How do delivery patterns reflect these tax-motivated exchanges?

Have IRS and Treasury discussed the negative impact on debt management decisions which result from these tax-motivated trading patterns?

Would simply eliminating delivery except for legitimate hedgers and looking to the market price on the date of settlement eliminate the conversion problem and assuage debt management concerns?

Should conversion of the futures contract into the T-bill itself be considered a taxable "sale or exchange" of assets?

Could gains or loss on exchange before maturity simply be apportioned to reflect interest and capital gain components?

IV. TAX SHELTERS

Describe the tax shelters in futures trading which IRS considers to be "abusive" or a tax administration problem.

Does IRS have or anticipate beginning special auditing programs for futures trading gains and losses?

Banks must provide interest and dividend statements to the Service. Shouldn't there be similar automatic reporting provisions for commodity firms and markets?

What cooperative efforts are underway, through Treasury or the CFTC, to require reporting by foreign traders and exchanges?

Wouldn't the elimination of abusive tax shelters, with their attendant artificial losses and tax deferral, contribute toward dampening inflation in the basic commodities and stem major losses in legitimate tax revenues, often by those most capable of payment?

How will sorting returns on the basis of Total Positive Income, rather than Adjusted Gross Income, help IRS identify abusive tax shelters?

What liabilities and responsibilities do attorneys presently have when writing opinions on tax shelters?

Answers to Specific Questions Raised by the Subcommittee in the letter of May 16, 1980

Any statements interpreting the tax laws are intended to reflect general principles and policies and should thus be viewed as generalizations only that may not apply in any particular case; the tax consequences of any specific transaction or combination of transactions can only be determined by analyzing all of the relevant facts and circumstances.

I. PRICIPLES AND POLICY

A. Discuss the general principles for tax treatment of option or futures contracts and the closely-related underlying commodities.

In general, gain or loss on a sale or exchange of options, futures contracts, and commodities are recognized for Federal income tax purposes. In general, gains and losses on such assets are treated as capital gains or losses unless the property is inventory of the taxpayer or otherwise used in the taxpayer's trade or business. See section 1221 of the Internal Revenue Code for a more detailed listing of assets not subject to capital gain or loss treatment. Thus, taxpayers who are dealers in commodities will have ordinary income or loss upon the sale of the commodities. Similarly, taxpayers who use futures contracts as an integral part of their trade or business will have ordinary income or loss when a contract is sold or otherwise disposed of.

Corn Products Refining Company v. Commissioner, 350 U.S. 46 (1945). A short sale of commodity futures will result in capital gain or loss if the commodity future used to close the short sale is a capital asset to the taxpayer. Section 1233(a). Gain or loss in the case of a purchaser of a put or call is considered a gain or loss from an asset which has the same character as the property to which the put or call relates. Section 1234(a). However, gain or loss for the grantor of a put or call in respect of securities, commodities, and commodity futures, if the gain or loss results from a "closing transaction" (generally, a repurchase of the option) or the lapse of the option,is treated as a short-term capital gain or loss, without reference to the character of the underlying property in the hands of the grantor. Section 1234(b).

In general, if a taxpayer has an option to acquire property, and exercises that option, the exercise of the option is not considered a taxable event, and the taxpayer's cost of the option is simply included in his tax cost for the property. Similarly, if a taxpayer grants a put or call in respect of property and the call is exercised, the amount of the call is included in the amount realized in respect of the property. However, no taxable event is deemed to occur before the call is exercised. A similar rule applies to puts. If a taxpayer is long in a commodity futures transaction, the taxpayer has no taxable event if he accepts delivery on the contract. In the case of a short position in a commodity, if the taxpayer closes out the position, his gain or loss will generally be short-term.

Although the dividing line between short-term and long-term capital gain is normally fixed at a one-year holding period, in the case of commodity futures subject to the rules of a board of trade or commodity exchange, the holding period for long-term capital gains remains more than six months rather than more than one year. Section 1222 of the Code.

B. Are agricultural commodities and futures contracts treated any differently than financial instruments and the related futures contracts?

Except as discussed below in question D, in the case of short-term discounted Treasury obligations, there are generally no differences between the two.

C. Are hedgers in the futures and cash markets treated differently than speculators?

As indicated above, gains and losses of speculators are generally treated as capital gains and losses while gains and losses of hedgers who use the underlying commodity in their business are generally treated as ordinary gains and losses, both with respect to the commodities and the futures contracts. Also, the rules of section 1233 dealing with gains and losses from short sales do not apply to hedging transactions in commodity futures. Section 1233(g) of the Code.

D. Discuss the specific provisions which apply to Treasury bill futures and the underlying instrument, and if they differ from the treatment of other financial instruments or agricultural commodities, the policy reasons or rationale for such differences.

The only special provision involving Treasury obligations is section 1221(5) of the Code, which excludes from the category of "capital assets" "an obligation of the United States . . . issued . . . on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue." This special provision for short-term discounted government obligations obviates the need for distinguishing the interest component of the discount from any gain or loss that might arise.

II. DEFERRAL

A. Discuss methods used in futures trading to defer tax liabilities, including "straddles" and "spreads". What are any present or proposed restrictions on these techniques?

As indicated more fully in the Commissioner's testimony, a commodity straddle can be used to attempt to defer tax liability. The IRS has ruled that such attempts at deferral will not be recognized for tax purposes. Rev. Rul. 77-185, 1977-2 C.B. 48 (Silver Straddle); Rev. Rul. 78-414, 1978-2 C.B. 213 (Treasury Bills Straddle).

Taxpayers also use a "cash and carry" transaction to attempt to defer income. The taxpayer will purchase a spot commodity borrowing funds to make the purchase, and simultaneously go short on a futures contract for that commodity in the following year. The taxpayer will claim the carrying costs for holding the commodity (including the interest on the purchase price and storage cost, and other similar costs) as ordinary deductions in the current year and will then claim a gain when the commodity is used to effect delivery on the futures contract. This transaction is entered into in connection with precious metals, where the maximum gain on the transaction will rarely, if ever, exceed the carrying cost (since arbitrageurs will quickly step in if the potential gain exceeds the carrying cost). Where there is little or no prospect for significant economic gain (other than the tax benefits), the Service's position is that the deductions are not allowable in the first year.

B. The "Wash Sale" rule disallows deduction for losses incurred if a trader enters into a "substantially similar" position for no economic purpose except tax avoidance. Discuss present application of and proposed changes in the Wash Sale rule for futures trading.

The Wash Sale rule of section 1091 generally provides that no loss will be allowed from the disposition of stock or securities if the taxpayer has acquired or contracted to acquire "substantially identical" stock or securities within a period beginning 30 days before the disposition and ending 30 days after the disposition. Section 1091 does not apply to commodity futures. Rev. Rul. 71-568, 1971-2 C.B. 312.

C. Has the IRS considered a simple mechanical year-end wash sale rule which would prevent tax deferral without the difficult analysis of a taxpayer's motive or purpose? If IRS simply disallowed a deduction in one year where the futures trader carries an unrealized profit into the next in a similar position, wouldn't tax deferral be greatly minimized?

As indicated above, the mechanical rule in section 1091 does not generally apply to commodities futures transactions. There are many circumstances, including the straddles described above, where the IRS presently disallows a deduction in one year if the futures trader carries an unrealized profit into the next year in a similar position.

III. CONVERSION

A. What tax inducements are there for futures traders to actually take delivery of Treasury Bills? How do delivery patterns reflect these tax-motivated exchanges?

As indicated above, certain short-term Treasury obligations, but not a futures contract for such obligations, are ordinary assets even if held for investment. Accordingly, a taxpayer holding a futures contract in such Treasury obligations which has declined in value, would have an inducement to take delivery of the Treasury obligations, and immediately sell the obligation thus producing an ordinary loss. If the taxpayer simply closed out the futures contract without taking delivery, the loss would be capital and not ordinary. The Treasury Department will supply data regarding the delivery patterns of Treasury obligations.

B. Have IRS and Treasury discussed the negative impact on debt management decisions which result from the tax-motivated trading pattern?

We understand that the debt management considerations of these delivery patterns are under study at the Treasury.

C. Would simply eliminating delivery except for legitimate hedgers and looking to the market price on the date of settlement eliminate the conversion problem

and assuage debt management concerns?

We do not know the debt management consequences of such a proposal. Such a proposal would not eliminate all situations where delivery of Treasury obligations occurs for tax purposes. Taxpayers presently engage in straddles involving actual ownership of Treasury obligations and a short position in other debt obligations which are capital assets in the taxpayer's hands.

D. Should conversion of the futures contract into the T-bill itself be considered a taxable sale or exchange of assets?

Such a legislative approach should consider the treatment of puts, calls, and other options in this context.

E. Could gains or losses on exchange before maturity simply be apportioned to reflect interest in capital gain components?

Such a result would be possible if a legislative change were made in section 1221. This is the rule that applies to short-term discount corporate obligations.

IV. TAX SHELTERS

A. Describe the tax shelters in futures trading which IRS considers to be "abusive" or a tax administration problem.

The straddle transaction described in the Commissioner's testimony, as well as the "cash and carry" transaction described above, are among the more frequently seen tax shelter transactions involving futures trading. These transactions are used by taxpayers in an attempt to defer the payment of tax and, in some cases, to attempt to change the character of income from ordinary income to capital gain, or from short-term capital gain to long-term capital gain. As indicated in the revenue rulings cited above and in the positions taken in court proceedings, the IRS believes these transactions do not produce the tax benefits claimed. The IRS expects to identify and audit those returns claiming tax benefits from these transactions. Abusive tax shelters are a serious problem to tax administration. They are engaged in largely by high income taxpayers adding to the perception among most that the high income taxpayers are not bearing their fair share of the tax burden, thereby diminishing respect for the tax system. Combating these abuses requires a very large commitment of IRS resources.

B. Does IRS have or anticipate beginning special auditing programs for futures trading gains and losses?

This matter is discussed in the Commissioner's testimony.

C. Banks must provide interest and dividend statements to the Service. Shouldn't there be similar automatic respoting provisions for commodity firms and markets?

The IRS has the authority to require returns from brokers under section 6045 of the Code. The problem with the transactions discussed above is not that taxpayers are failing to report their transactions; they are reporting their transactions. The problem is that taxpayers are taking positions regarding the tax consequences of the transaction which are inconsistent with IRS rulings or basic tax principles.

D. What cooperative efforts are underway, through Treasury or the CFTC, to require reporting by foreign traders and exchanges?

We are not aware of any such efforts.

E. Wouldn't the elimination of abusive tax shelters, with their attendent artificial losses and tax deferral, contribute toward dampening inflation in the basic commodities and stem major losses in legitimate tax revenues, often by those most capable of payment?

Since it is clear that the losses claimed by taxpayers from these transactions distorts the taxpayer's income, we would agree that if any such losses were permitted by the courts, unwarranted losses in tax revenues would result. We are not in a position to measure the effect that these transactions have on inflation.

F. How will sorting returns on the basis of Total Positive Income, rather than Adjusted Gross Income, help IRS identify abusive tax shelters?

This issue is discussed in the Commissioner's testimony.

G. What liabilities and responsibilities do attorneys presently have when writing opinions on tax shelters?

The matter of the responsibility of attorneys in writing opinions in tax shelters is one which gives us great concern. We are attaching a copy of the remarks of Robert Mundheim, General Counsel of the Treasury Department, before the Securities Regulations Institute on January 18, 1980, which express our concerns in this area.

As stated above, general statements of applicable rules are intended as generalizations only and may not be applicable in any particular case; such generalizations are subject to judicially developed principles including the principle that, in appropriate cases, the economic substance of a transaction or a series of transactions prevails over form.

Department of the TREASURY NEWS

Remarks of Robert H. Mundheim
General Counsel of the Treasury Department
Before the
Securities Regulation Institute
San Diego, California
Friday, January 18, 1980

DEVELOPING STANDARDS FOR TAX ATTORNEYS

I want to talk about abusive tax shelters, a problem of concern to the SEC, but of even greater concern to the Treasury.

We view abusive tax shelters as one of IRS' most serious compliance problems. IRS has identified as abusive approximately 18,000 shelters promoted in recent years, involving 182,000 taxpayers and almost $4.5 billion in adjustments.

I. What is an "abusive" shelter?

An "abusive" tax shelter is a transaction without any economic purpose other than the generation of tax benefits that typically employs exaggerated valuations of assets and otherwise mischaracterizes critical aspects of the transaction.

Let me outline one example of an abusive tax shelter.

Taxpayers are offered an original lithographic plate made by a specific artist (albeit not a renowned artist) plus the right to a limited-edition of prints pulled from the plate under the artist's supervision. The transaction is characterized as a sale of the lithographic plate. The sale price is $200,000: $30,000 in cash and the balance in the form of a partial recourse note due in 12 years. The non-recourse portion of the indebtedness is secured only by the assets purchased and the proceeds. In the event of default, the taxpayer can satisfy his personal liability by turning over to the

noteholder any of the unsold prints at a value based on a formula linked to the last retail sales of the prints.

The taxpayer is told that he is entitled to accelerated depreciation, an interest deduction, and an investment tax credit on his purchase of the lithographic plate. Because of the leverage involved — $30,000 in cash purchasing an asset valued at $200,000 — the tax benefits would be substantial. A 50% bracket taxpayer would more than recoup his out-of-pocket costs in tax savings and credits the very first year and by the second year would more than double those out-of-pocket costs in tax benefits.

The key to the transaction is the valuation placed on the lithographic plate. The higher the valuation, the greater the deductions due to accelerated depreciation and the higher the investment tax credit. The abusive tax shelter is that rare transaction in which the interests of both the purchaser and the seller of an asset are served by the highest possible valuation of the asset exchanged.

Of course, the high value of the asset must be coupled with assurance to the taxpayer that he will not be called on to pay the full price. Financing the purchase with non-recourse notes would be the obvious way to achieve this result. But in 1976 and 1978 Congress tightened up on the extent to which the taxpayer could obtain tax benefits from the use of non-recourse financing. Now, losses generated by a shelter (except for real estate) are available only to the extent the taxpayer actually is "at risk" in the transaction. The current abusive tax shelter seeks to avoid these reforms by structuring the financing so that recourse to the taxpayer is provided in appearance, but not in effect.

In my example that result is created by allowing the first few sales of the prints to set the value of all subsequent prints turned in to discharge the indebtedness of the outstanding notes.

II. Treasury Interest and Activity

The SEC has pursued promoters of abusive tax shelters because the value of assets purchased by investors was misrepresented, tax risks were inadequately disclosed, and investors were denied promised deductions. But in light of the intent of investors in entering into many of the transactions, there is some irony in viewing these cases as raising significant investor protection issues.

The true victim of those schemes tends to be the Treasury - i.e., all taxpayers. Investors in these schemes seek to evade their fair share of the tax burden. The widespread nature of those schemes undermines the public's confidence in the fairness of the tax system and may affect the level of voluntary compliance.

IRS has attacked abusive tax shelters on a number of fronts:

-- Beginning in 1973, the Service has established a program aimed at identifying abusive shelters, auditing returns of shelter purchasers, and obtaining uniform treatment nationwide of specific shelter promotions. This program has been greatly expanded in the past two years. Once an abusive promotion has been identified, there is followup on the individual returns of investors who participated in the shelter. Once selected, the whole return is open for audit. In some cases, the investors may be liable for fraud or negligence penalties.

— Indeed, IRS may refer particularly egregious cases to the Department of Justice for prosecution.

— In general, the Service has become increasingly willing to litigate individual cases and increasingly reluctant to accept a settlement in which the investor is allowed to deduct out-of-pocket costs.

-- The Service has tried to issue rulings quickly on abusive shelters so that investors and the public will know where it stands on particular transactions. Just this week the Service announced the formation of a special committee to expedite such rulings.

Unfortunately, the abusive tax shelter still flourishes.

III. The Role of the Tax Attorney

One of the critical elements in promoting an abusive tax shelter scheme is the tax opinion supplied by the promoter's tax attorney. The theory is that the tax opinion, even if qualified, provides the investor assurance that a negligence or fraud penalty will not be assessed even if deductions taken under the shelter are disallowed on audit. At a minimum the tax opinion is viewed as fraud insurance. With fraud insurance the investor is protected against loss. If no fraud penalty is assessed, the deferral benefits of deductions taken, even if ultimately disallowed some years hence, will generally protect the investor from losses on the shelter.

I must tell you that Treasury is becoming increasingly concerned about the role in which some tax attorneys are allowing themselves to be cast. Much like securities lawyers in the sale of letter stock, tax attorneys through their opinions control access to the market place. That power, and the privileged position given the attorney by our system of law and government, creates professional responsibilities which we feel are not sufficiently appreciated in the tax shelter area.

Let me describe a number of the types of opinion which we see and which cause us concern.

The first is the intentionally false or totally incompetent opinion. These opinions knowingly or recklessly misstate facts or the law, or ignore or minimize serious legal risks to the taxpayer's claiming the tax advantages advertised as flowing from the shelter.

The second is the "don't bother me with the facts" opinion. These opinions may state that the taxpayer will obtain the tax benefits held out by the tax shelter, if the facts of the transaction are as represented by the promoter. The opinion disclaims knowledge of the accuracy of those facts. As I indicated in my model case, the key fact is frequently the value of the asset to be purchased -- in that case the value of the lithographic plate. The character of the transaction itself may show an experienced person that the appraised value is inflated. Why would a lithographic plate valued at $200,000 be sold for $30,000 down, the balance represented by very thinly secured notes? In others, a rudimentary investigation would indicate the presence of facts which throw serious doubt on the ability of the transaction to qualify for the asserted benefits.

A third category of troublesome opinions is the non-opinion. These legal memoranda look like opinions because they discuss the law applicable to tax shelters, but never relate the law to the facts of the particular transaction at issue. Frequently resembling law review articles in length and in balanced appraisals of the legal issues, these opinions lack analysis of the critical facts of the transaction and do not really opine on the tax consequences of the transaction. A variation of this form of opinion is the hypothetical opinion, which analyzes the consequences of given facts without passing on the relevance of the hypothetical to the particular shelter being offered.

A fourth category is the "reasonable basis but you'll probably lose" opinion. These opinions (which are also lengthy) point out that there is a reasonable basis for the claimed tax benefits, but warns the taxpayer that if he is audited, his claims would be challenged and that under existing law he would probably lose.

Tax opinions generally cover many questions, and a single opinion may fall into more than one category.

The first question is which of these opinions represent unprofessional conduct. The second is what should be done about such conduct.

There is probably little disagreement that the giving of an intentionally or recklessly misleading opinion or a pattern of providing incompetent opinions can properly be regarded as involving unprofessional conduct.

The securities lawyers here would probably also find the "don't bother me with the facts" opinion to be unprofessional.

A series of SEC releases and anti-fraud actions make it clear that a securities lawyer may not close his eyes to the actual facts and circumstances of the transaction with respect to which he is giving an opinion. ABA Opinion 335, relating to private placements, also makes it clear that a lawyer must make relevant inquiry into the actual facts before opining as to the availability of an exemption from registration. When the facts presented by the client seem suspect, the lawyer has a duty to make further inquiry, and if he is not satisfied as to all the relevant facts, he should refuse to give an opinion.

In the non-opinion the lawyer closes his eyes to his client's use of the opinion. Of course, it is proper for a lawyer to educate a client through a discussion of a general area of the law, or by evaluating the consequences of a hypothetical set of facts. But is it professional to allow such an opinion to be used as a promotional tool for a transaction to which the opinion does not specifically relate? Use of the opinion in that circumstance is likely to mislead. Is acquiescence in such conduct professional?

The "reasonable basis" opinions present a more difficult case.

Tax lawyers come from a tradition in which, as Judge Learned Hand put it, ". . . there is nothing sinister in so arranging one's affairs to keep taxes as low as possible." Indeed, ABA Opinion 314 contemplates an adversarial relationship with the IRS and states that while the attorney may not mislead, he is "under no duty to disclose the weakness in his client's case." Such a tradition has led to the view that a tax lawyer may sign his client's tax return even though it takes a position he thinks wrong as long as there is a "reasonable basis" in fact and law for it.

Is the lawyer's role in advising a single client with respect to a transaction already consummated to be governed by the same standards as the lawyer's role in helping set up and promote a tax shelter to be offered to numerous investors? A substantial number of thoughtful tax practitioners take the view that it is unprofessional conduct for an attorney to give a "reasonable basis" opinion that he knows will be used to lead many people to assert tax positions that he believes are not sustainable. In its recently published Guidelines for Tax Practice, the Committee on Standards of Tax Practice of the ABA Section of Taxation warned that in the circumstances of promoting a tax shelter, the giving of an opinion "may be taken by the public as our endorsement of the program." Accordingly, the Guidelines take the view that tax attorneys should not assist in the offering of tax shelters which are without economic substance and without a substantial likelihood of legal validity.

The rendering of the types of opinions I have discussed puts significant pressure on the careful practitioner.

— When his client appears, ready to buy into an abusive tax shelter scheme apparently blessed by a lengthy, formal tax opinion of another attorney, the careful practitioner has the unpleasant task of explaining to his client that the promised tax benefits cannot properly be taken.

— When the promoter offers a substantial fee for an opinion, even if elaborately qualified, the lawyer knows that another practitioner will give the opinion if he does not.

The careful practitioner thus has a vital interest in the provision of clear and effective guidance with respect to the conduct of tax attorneys.

I would prefer such guidance, and follow up, to come from the bar itself. We have been encouraged by increasing discussion of the problem by bar groups, particularly by the detailed examination of the problem in Dallas last summer, and by the work of the Tax Practice Standards Committee in formulating its Guidelines.

Hopefully, this discussion and work will result soon in the publication of a formal ABA Opinion on the subject. ABA Opinion 335 was a useful tool for dealing with a problem which disturbed the SEC, but which the private bar could take a substantial role in resolving. Since ABA Opinion 314, dealing with the preparation of individual returns may be seen as giving confusing signals to the lawyer assisting the creation of a tax shelter promotion, a formal opinion would be particularly helpful.

Bar Association articulation of standards of conduct must be accompanied by a demonstrated willingness to discipline those who fail to meet them. Performance generally in this area has not been as vigorous or effective as those of us who believe in self-regulation would like.

Treasury officials such as Commissioner Kurtz and IRS Chief Counsel Jerold Cohen have been active in calling the bar's attention to the special problems presented by the tax opinion in shelter promotions. Our interest, however, is more direct than encouraging others to act.

Treasury has broad statutory and regulatory authority to discipline those who practice before it. Our statute, 31 U.S.C. §1026 explicitly authorizes the disbarment or suspension of attorneys from practice before the Treasury — which of course includes IRS — on a finding that they are incompetent, disreputable, or have fraudulently misled a "prospective claimant." Treasury Circular 230, codified in 31 CFR Part 10, sets forth the duties of practitioners before the IRS and the grounds and procedures for disbarment or suspension. It might be noted parenthetically that

Treasury's explicit statutory mandate puts us in an even clearer position than the SEC to discipline those who practice before us.

Treasury disciplinary proceedings work as follows. Cases of alleged misbehavior are initially handled by the Director of Practice, a Treasury official in the Office of the General Counsel. The Director of Practice investigates cases and, on appropriate findings, may either reprimand a practitioner or institute a proceeding for disbarment or suspension. Contested proceedings are heard by an administrative law judge, whose decision may be appealed to the General Counsel.

As presently drafted, our practice regulations require an attorney to exercise due diligence in assisting in the preparation of documents relating to IRS matters and in determining the correctness of representations made by him to clients. (§10.22) The regulations also provide for attorney discipline on the grounds of incompetence, disreputable conduct, or certain instances of knowing misrepresentations. (§10.50)

The Director of Practice is now reviewing recent tax shelter promotions to pick up egregious instances of professional misconduct and to determine whether our present regulations provide an adequate basis for initiating disciplinary proceedings.

Carr Ferguson, the Assistant Attorney General for the Tax Division, has told me that the Department of Justice would be receptive to considering the prosecution of tax attorney misconduct in tax shelter cases.

We have also been pressed to consider elaborating our present Circular 230 regulations specifically to cover attorney conduct in tax shelter cases. One suggestion has been to define as an example of disreptable conduct cases in which a practitioner is found by a court or another administrative agency to have engaged in fraudulent activity. Adoption of such a regulation would allow us to give collateral estoppel affect to a determination by the SEC that a tax practitioner has participated in the fraudulent sale of securities by the giving of his opinion. There are a number of problems with such an approach. One of them is that it deals only with a small part of the question we have been discussing this afternoon.

Another suggestion has been for Treasury to define by regulation what constitutes "disreputable conduct" in the tax shelter area. Such an action would permit a comprehensive approach to the problem. On the other hand, it would start us well down the road of promulgating codes of conduct for tax practitioners. The SEC experience does not make me an enthusiastic supporter of such a journey.

As I indicated earlier, I would prefer to see vigorous and speedy action by the tax bar. But if an appropriate response is not forthcoming, we may be forced to act. Abusive tax shelters are a serious problem, and the direct action which the IRS has taken has not yet solved it. A solution appears to require restraining the unprofessional conduct of tax lawyers in providing the fraud insurance which makes possible the widespread sale of abusive tax shelters. The time to take that action is at hand.

* * * * * * *

[Whereupon, at 11:15 a.m. the subcommittee adjourned, to reconvene subject to the call of the Chair.]

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APPENDIXES

APPENDIX 1.—CORRESPONDENCE

A. BENJAMIN S. ROSENTHAL LETTER TO NELSON BUNKER AND WILLIAM HERBERT HUNT, APRIL 7, 1980

Mr. Herbert Hunt
Mr. Nelson Bunker Hunt
2500 First National Bank
Dallas, Texas 75202

The Commerce, Consumer and Monetary Affairs Subcommittee (U.S. House Committee on Government Operations) requires your appearance and testimony at hearings into the Federal Government's response to recent events in the silver markets and the impact of those events on the securities and other financial markets. The hearing will be held on Monday, April 14, 1980, Room 2247 of the Rayburn House Office Building, Washington, D.C., at 10 A.M.

In view of your involvement in these markets and media reports of your attempted corner on silver, we need your testimony as to the following:

What triggered the market movements during the week ending March 28, 1980?

How do foreign markets compare with American excnanges, particularly COMEX and CBOT?

Did any actions taken by these two exchanges contribute to the markets' disruption?

Has Federal Reserve policy, including the recent series of rapid prime rate increases, impacted the futures markets? The value of physical silver?

How have the policy and practices of the Commodity Futures Trading Commission (CFTC) affected silver futures trading? Are there any recommendations you would make to the CFTC?

How has Securities and Exchange Commission (SEC) policy affected the silver markets?

What information on foreign traders and commodities should be available to the CFTC?

What kinds of futures trading are moving out of the United States?

What might be the effects of this movement? Describe the self-regulatory mechanism of the London exchange.

Can speculative money ever be a danger in the futures market? Should there be limits on the amount of a commodity controlled by any one speculator?

Paul Sarnoff of Conticommodity Services, Inc., described your silver trading as a "classic tax straddle". Would you comment?

Describe your relationship with the Bache Groupe, Inc., including subsidiaries, Engelhard Minerals and Chemical Company, Gulf Resources and Chemical Corporation, and Sunshine Mining.

What additional recommendations would you make as an individual trader to the Congress and Federal regulatory agencies which share jurisdiction for the financial markets?

Although the Rules of the House of Representatives give the subcommittee subpoena authority, we would prefer your voluntary cooperation in our efforts to provide a full and complete hearing record.

If there are any questions regarding this request, please contact Peter Barash, staff director of the subcommittee, or Barbara Timmer, counsel to the subcommittee, on 202-225-4407.

Benjamin S. Rosenthal
Chairman
Commerce, Consumer and
Monetary Affairs Subcommittee

B. RESPONSE DATED APRIL 11, 1980

SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE
ATTORNEYS AT LAW
3100 FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202
(214) 748-9696
TELECOPIER
(214) 748-6880

RALPH B. SHANK
FRED IRWIN, JR.
A. B. CONANT, JR.
[illegible] B. WILLIAMSON
JAMES V. GREVELLE
CECIL W. CASTERLINE
RODNEY D. FLETCHER
WILLIAM E. DOUGLASS
ROBERT B. COUSINS, JR.
STEVEN C. METZGER
ALLEN WEED
ROBERT H. RULE, JR.
KAREN S. BEDELL
WILLIAM D. [illegible]
GARY E. SMITH
JOHN D. [illegible]
[illegible]
CHARLES F. [illegible]
DON H. HEARD III
DREW R. HEARD
CHARLES W. [illegible]
WILLIAM D. WRIGHT
RODERIC C. STEAKLEY
J. RICHARD [illegible]
FREDERICK J. [illegible]
ROBERT J. [illegible]
JOHN H. PEPER
KATHLEEN S. CLEAVELAND
P. TALMADGE BOSTON, JR.
C. WEBB SPRADLEY
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IN DENVER, COLORADO
SHANK, IRWIN & HOLMES
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IN WASHINGTON, D.C.
SHANK, IRWIN, CONANT,
WILLIAMSON & GREVELLE
[illegible] 20036
(202) 659-0406

RECEIVED
[illegible] 1 4 1980
COMMITTEE [illegible] CONSUMER AND
MONETARY AFFAIRS SUBCOMMITTEE

CONGRESSMAN BEN ROSENTHAL
RECEIVED
DOC # ____
MC # ____
APR 14 1980
FILE CODE ____

April 11,1980

Honorable Benjamin S. Rosenthal
United States House of Representatives
Washington, D.C. 20515

Dear Congressman Rosenthal:

This firm represents Mr. Nelson Bunker Hunt and Mr. William Herbert Hunt.

This letter is in response to a telegram from you addressed to our clients, dated April 7, 1980, requesting their appearance before the Commerce, Consumer and Monetary Affairs Subcommittee of the United States House Committee on Government Operations (the "Subcommittee") to testify on a variety of topics delineated in that telegram.

Since the receipt of the telegram by our clients, I have had several conversations with counsel for the Subcommittee, Ms. Barbara Timmer. I have explained to Ms. Timmer that our clients wish to cooperate with the Subcommittee. On the other hand, I am sure you can recognize that the scope of the matters upon which the Subcommittee desires to inquire is extensive and complex. As I have previously explained to Ms. Timmer, it is virtually impossible for our clients to evaluate your request and to prepare properly for any such appearance on the limited notice afforded by the telegram.

Ms. Timmer has requested a date certain upon which our clients would be available to appear before the Subcommittee. I have been unable to talk with either of them concerning such a commitment. I have, therefore, advised Ms. Timmer that I shall contact her early next week to discuss a potential date for such appearance.

We would respectfully request that this letter be made a part of the permanent record of your Subcommittee.

Respectfully,

Robt B. Cousins Jr

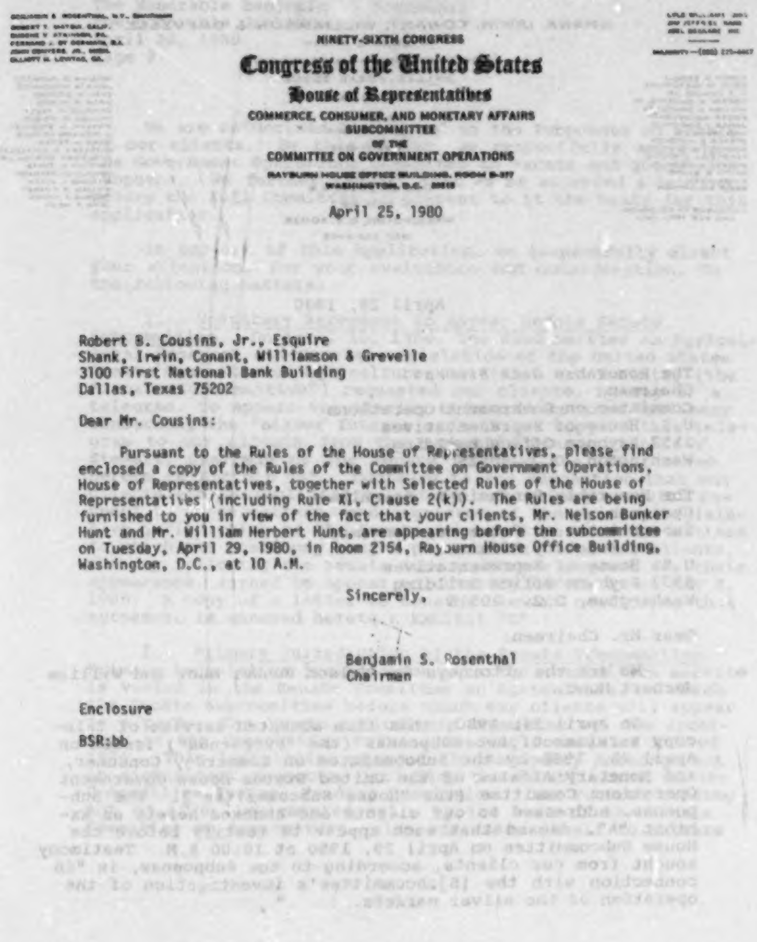
Robert B. Cousins, Jr.

RBC/RG:ch

cc: Honorable Benjamin S. Rosenthal,
Chairman
Commerce, Consumer and Monetary Affairs
Subcommittee
Room B 377 Rayburn House Office Building
Washington, D.C. 20515

cc: Ms. Barbara Timmer
Counsel
Room B 377 Rayburn House Office Building
Washington, D.C. 20515

C. BENJAMIN S. ROSENTHAL LETTER TO ROBERT B. COUSINS, ATTORNEY FOR THE HUNTS, APRIL 25, 1980



NINETY-SIXTH CONGRESS
Congreſs of the United States
House of Representatives
COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

April 25, 1980

Robert B. Cousins, Jr., Esquire
Shank, Irwin, Conant, Williamson & Grevelle
3100 First National Bank Building
Dallas, Texas 75202

Dear Mr. Cousins:

Pursuant to the Rules of the House of Representatives, please find enclosed a copy of the Rules of the Committee on Government Operations, House of Representatives, together with Selected Rules of the House of Representatives (including Rule XI, Clause 2(k)). The Rules are being furnished to you in view of the fact that your clients, Mr. Nelson Bunker Hunt and Mr. William Herbert Hunt, are appearing before the subcommittee on Tuesday, April 29, 1980, in Room 2154, Rayburn House Office Building, Washington, D.C., at 10 A.M.

Sincerely,

Benjamin S. Rosenthal
Chairman

Enclosure

BSR:bb

D. LETTER TO JACK BROOKS AND BENJAMIN S. ROSENTHAL FROM HUNT ATTORNEYS, APRIL 29, 1980

SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE
ATTORNEYS AT LAW
[illegible] FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202
[illegible]
TELECOPIER
[illegible]
TELEX [illegible]
IN WASHINGTON, D.C.
[illegible] STREET, N.W.
SUITE [illegible]
WASHINGTON, D.C. 20036
[illegible]

April 28, 1980

The Honorable Jack Brooks
Chairman
Committee on Government Operations
U.S. House of Representatives
2157 Rayburn Office Building
Washington, D.C. 20515

The Honorable Benjamin S. Rosenthal
Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs
U.S. House of Representatives
B377 Rayburn Office Building
Washington, D.C. 20515

Dear Mr. Chairmen:

We are the attorneys for Nelson Bunker Hunt and William Herbert Hunt.

On April 24, 1980, this firm accepted service of telecopy versions of two subpoenas (the "Subpoenas") issued on April 23, 1980 by the Subcommittee on Commerce, Consumer, and Monetary Affairs of the United States House Government Operations Committee (the "House Subcommittee"). The Subpoenas, addressed to our clients and annexed hereto as Exhibit "A", demand that each appear to testify before the House Subcommittee on April 29, 1980 at 10:00 A.M. Testimony sought from our clients, according to the Subpoenas, is "in connection with the [S]ubcommittee's investigation of the operation of the silver markets. . . .".

We are authorized to respond to the Subpoenas on behalf of our clients. By this letter, we respectfully apply to the Government Operations Committee to vacate and quash each Subpoena. We further request that we be accorded a hearing before the full Committee to present to it the basis for this application.

In support of this Application, we respectfully direct your attention, for your evaluation and consideration, to the following matters:

1. Voluntary Agreement to Appear Before Senate Subcommittee. On April 16, 1980, the Subcommittee on Agricultural Research and General Legislation of the United States Senate Committee on Agriculture, Nutrition and Forestry (the "Senate Subcommittee") requested our clients, by way of a telegram, to appear voluntarily before it to give testimony concerning the "silver futures market". A copy of this telegram to our clients from the Honorable Senator Donald W. Stewart, Chairman of the Senate Subcommittee, is annexed hereto as Exhibit "B". Contrary to any suggestion that our clients are disinclined to testify before Congress with respect to these matters, and cognizant of the primary legislative jurisdiction of the Senate Subcommittee over the matters to which the testimony sought pertains, each of our clients, one day following the Senate Subcommittee's request for their appearance, agreed to appear voluntarily before it on May 2, 1980. A copy of a letter to Senator Stewart confirming that agreement is annexed hereto a Exhibit "C".

2. Primary Jurisdiction of the Senate Subcommittee. Primary legislative jurisdiction over the commodities markets is vested in the Senate Committee on Agriculture, of which the Senate Subcommittee before which our clients will appear is a part. The Senate Agriculture Committee was the architect of the Commodities Futures Trading Commission Act of 1974. This legislation amended the Commodity Exchange Act in significant respects, including the establishment of the Commodities Futures Trading Commission. The Futures Trading Act of 1978, implemented again by the work of the Senate Committee on Agriculture, also addresses itself to matters

upon which our clients are called to provide testimony. Indeed, the House Committee on Agriculture[1] cooperated with the Senate Committee to make significant contributions to the passage of the Futures Trading Act of 1978. We submit that the willingness of our respective clients to appear voluntarily before the Senate Committee of the Congress vested with primary legislative jurisdiction over commodities trading matters adequately fulfills their responsibility to furnish testimony to Congress.

3. Cooperation between House and Senate. One day following our clients' agreement to appear voluntarily before the Senate Subcommittee, we contacted staff counsel for the House Subcommittee. We advised counsel of the intention of each of our clients to appear and to testify voluntarily before the Senate Subcommittee. We further suggested that the House Subcommittee coordinate with the Senate Subcommittee to facilitate an orderly and efficient presentation of our clients' testimony. We likewise suggested that members of the Senate Subcommittee inquire of our clients concerning those matters that members of the House Subcommittee desired to explore, provided that such matters were relevant to this inquiry. Those suggestions were not met with favor. Subpoenas thereafter issued from the House Subcommittee, returnable on April 29, 1980. At the time of their issuance, all parties in interest were certainly aware that our clients were appearing before a Senate Subcommittee voluntarily to testify ar to the silver futures market only three days later.

4. Comity and Fundamental Fairness. Our clients urge that they not be subject to an environment of competition for their testimony. They recognize and fully appreciate the responsibilities of concerned legislators, both in the House and Senate. But they nevertheless suggest for your consideration the attendant consequences of multiple hearings, including duplication of testimony and expenditure of extraordinary effort, time and resources both on the part of Congressmen and of citizens. In addition, other Committees of Congress are also interested in the matters about which our clients will (and welcome the opportunity to) testify

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[1] As you know, primary legislative jurisdiction over "commodities exchanges" in the House of Representatives is vested in the House Committee on Agriculture. See Rule X(a) of the Rules of House of Representatives.

before the Senate Subcommittee. In light of our clients' anticipated appearance before the Senate Subcommittee on May 2, 1980, we urge that as a matter of comity, unity of effort and, indeed, fundamental fairness to all parties, the Subpoenas be vacated and quashed.

It is not without precedent that Committees of the House have delayed legislative inquiry because of reasons of fundamental fairness. In this regard, Mr. Justice Brennan, in a concurring opinion in Hutchinson v. United States, 369 U.S. 599, 625 (1962), stated that "even within the realm of relevant [House or Senate] inquiry, there may be situations in which fundamental fairness would demand a postponement of inquiry until after an immediate pending trial, or in the taking of testimony in executive session. . . ." Although the Court's opinion in Hutchinson was rendered in a context where there was a pending state proceeding which paralleled the inquiry of a legislative committee, it is clear from the underlying judicial reasoning that the public interests in legitimate legislative inquiry are not abridged by a delay or a postponement of such inquiry when countervailing issues of fundamental fairness to witnesses are involved. It is respectfully suggested that no prejudice will result to the Government Operations Committee and/or the House Subcommittee if the instant Subpoenas are vacated so that our clients will have an opportunity to complete, in an orderly fashion, their testimony before the Senate Subcommittee and, at the same time, attend to, in a responsible manner, various Executive agency demands for information. Given the circumstances, the vacating of the Subpoenas will be in the time-honored spirit of cooperativeness and comity between the House and Senate.

5. Willingness to Appear Before the House of Representatives. We are not suggesting, nor have we ever suggested in our discussions with House and Senate Staff Counsel, that the respective Committees of the House and Senate do not have the power to conduct investigations, inter alia, into the operation of the silver markets for legitimate legislative purposes. However, we respectfully suggest that such power is not unlimited. See Watkins v. United States, 354 U.S. 178 (1957); Kilborne v. Thompson, 103 U.S. 168 (1881). Further, we are in no way suggesting that the purpose of the House Subcommittee's inquiry is buttressed by anything other

The Honorable Benjamin S. Rosenthal
The Honorable Jack Brooks
April 28, 1980
Page 5

than a legitimate desire to evaluate and/or to oversee the proper operation of Executive offices, agencies and commissions within the House Subcommittee's jurisdiction. However, we respectfully contend that such legislative inquiry be juxtaposed and balanced against the effects that compelled testimony will have upon our clients, particularly at this juncture and in this proposed time sequence.

We do not mean to imply by this application that our clients are unwilling to appear before a Committee or Subcommittee of the House of Representatives in connection with these matters. Rather, in order to achieve proper harmony between competing Congressional and Executive interests, it is submitted that additional time is needed so that our clients can complete, in an orderly and responsible fashion, their scheduled testimony before the Senate and so that they may respond to certain Executive agency requests. We understand that the House Banking Committee and the House Agriculture Committee will hold hearings looking into recent events in the silver market. Various Senate Committees (other than Senator Stewart's Senate Subcommittee) intend to convene hearings on these matters. Accordingly, given the multiplicity of Congressional inquiries and Executive agency requests for information, our clients' request, and, indeed, are entitled to, an orderly, efficient and properly coordinated presentation of their testimony. That is, after all, one of the major premises upon which our application to vacate and quash the Subpoenas rests.

With deference, we respectfully ask that the Government Operations Committee set a hearing at a time mutually convenient to all parties to permit a detailed exposition of the merits of this application to vacate and quash the Subpoenas and to permit counsel to respond to any inquiries of Members of the full Committee relating to the instant application. We also respectfully request that this letter application be placed in, and made a part of, the permanent records of your respective Committees.

Respectfully submitted,

Roger Goldberg

Roger Goldberg

RG:hm

cc: The Honorable Frank Horton
The Honorable Lyle Williams

Received by Roger Goldburg
11:40 a.m. from Marshall Pope

80-4

ORIGINAL

BY AUTHORITY OF THE HOUSE OF REPRESENTATIVES OF THE CONGRESS OF THE UNITED STATES OF AMERICA

To United States Marshall

You are hereby commanded to summon William Herbert Hunt of Dallas, Texas

to be and appear before the Subcommittee on Commerce, Consumer and Monetary Affairs of the Government Operations Committee of the House of Representatives of the United States, of which the Hon. Benjamin S. Rosenthal is chairman, in connection with the subcommittee's investigation of the operation of the silver markets, the adequacy of CFTC regulation of those markets, and the impact of recent fluctuations in those markets, on the securities and other financial markets regulated by the SEC, the Federal Reserve, the U.S. Treasury Department and the Federal bank regulatory agencies

in their chamber in the city of Washington, on April 29, 1980, in Room 2154 of the Rayburn House Office Building, at the hour of 10 a.m.

then and there to testify touching matters of inquiry committed to said Committee; and he is not to depart without leave of said Committee.

Herein fail not, and make return of this summons.

Witness my hand and the seal of the House of Representatives of the United States, at the city of Washington, this 23rd day of April, 1980.

Jack Brooks

Jack Brooks, Chairman.

Attest: Edmund L. Henshaw Jr.
EDMUND L. HENSHAW, JR. Clerk.

By: W. Raymond Colley
W. Raymond Colley, Deputy Clerk

eceived by Roger Goldburg
1:40 a.m. from Marshall Pope

80-3

ORIGINAL

BY AUTHORITY OF THE HOUSE OF REPRESENTATIVES OF THE CONGRESS OF THE UNITED STATES OF AMERICA

To United States Marshall

You are hereby commanded to summon Nelson Bunker Hunt

of Dallas, Texas

to be and appear before the Subcommittee on Commerce, Consumer and Monetary Affairs of the Government Operations Committee of the House of Representatives of the United States, of which the Hon. Benjamin S. Rosenthal is chairman, in connection with the subcommittee's investigation of the operation of the silver markets, the adequacy of CFTC regulation of those markets, and the impact of recent fluctuations in those markets, on the securities and other financial markets regulated by the SEC, the Federal Reserve, the U.S. Treasury Department and the Federal bank regulatory agencies

in their chamber in the city of Washington, on April 29, 1980, in Room 2154 of the Rayburn House Office Building, at the hour of 10 a.m.

then and there to testify touching matters of inquiry committed to said Committee; and he is not to depart without leave of said Committee.

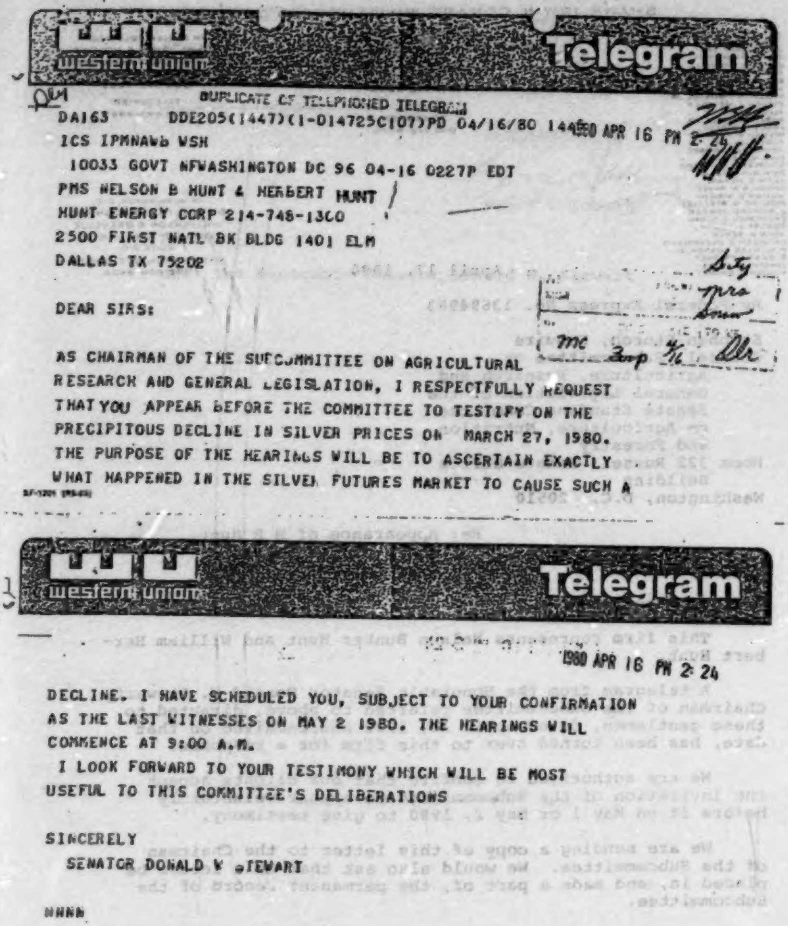
Herein fail not, and make return of this summons.

Witness my hand and the seal of the House of Representatives of the United States, at the city of Washington, this 23rd day of April 1980

Jack Brooks
Chairman.

Attest: Edmund L. Henshaw, Jr.
EDMUND L. HENSHAW, JR. Clerk

By: W. Raymond Colley
W. Raymond Colley, Deputy Clerk



western union
Telegram

DUPLICATE OF TELEPHONED TELEGRAM

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1980 APR 16 PM 2 24

ICS IPMNAWB WSH

10033 GOVT NFWASHINGTON DC 96 04-16 0227P EDT

PMS NELSON B HUNT & HERBERT HUNT

HUNT ENERGY CORP 214-748-1300

2500 FIRST NATL BK BLDG 1401 ELM

DALLAS TX 75202

MC 4/16

DEAR SIRS:

AS CHAIRMAN OF THE SUBCOMMITTEE ON AGRICULTURAL RESEARCH AND GENERAL LEGISLATION, I RESPECTFULLY REQUEST THAT YOU APPEAR BEFORE THE COMMITTEE TO TESTIFY ON THE PRECIPITOUS DECLINE IN SILVER PRICES ON MARCH 27, 1980. THE PURPOSE OF THE HEARINGS WILL BE TO ASCERTAIN EXACTLY WHAT HAPPENED IN THE SILVER FUTURES MARKET TO CAUSE SUCH A

SF-1201 (R5-69)

1980 APR 16 PM 2 24

DECLINE. I HAVE SCHEDULED YOU, SUBJECT TO YOUR CONFIRMATION AS THE LAST WITNESSES ON MAY 2 1980. THE HEARINGS WILL COMMENCE AT 9:00 A.M.

I LOOK FORWARD TO YOUR TESTIMONY WHICH WILL BE MOST USEFUL TO THIS COMMITTEE'S DELIBERATIONS

SINCERELY
SENATOR DONALD W STEWART

NNNN

SF-1201 (R5-69)

SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE
ATTORNEYS AT LAW
2100 FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202
(214) [illegible]

TELECOPIER
(214) [illegible]

[illegible]

IN DENVER, COLORADO
SHANK, IRWIN & HOLMES
717 17TH STREET SUITE 2440
DENVER, COLORADO 80202
(303) [illegible]

TELECOPIER
(303) [illegible]

IN WASHINGTON, D.C.
SHANK, IRWIN, CONANT,
WILLIAMSON & GREVELLE
1800 19TH STREET, N.W.
SUITE 210
WASHINGTON, D.C. 20036
(202) [illegible]

April 17, 1980

By Federal Express No. 13694983

Stephen Storch, Esquire
Counsel, Subcommittee on
Agriculture, Research and
General Legislation of the
Senate Standing Committee
on Agriculture, Nutrition
and Forestry
Room 322 Russell Senate Office
Building
Washington, D.C. 20510

Re: Appearance of N B Hunt
and W H Hunt Before
Subcommittee

Dear Mr. Storch:

This firm represents Nelson Bunker Hunt and William Herbert Hunt.

A telegram from the Honorable Senator Donald W. Stewart, Chairman of the Subcommittee referred to above, directed to these gentlemen, dated April 16, 1980 and received on that date, has been turned over to this firm for a response.

We are authorized to confirm that our clients accept the invitation of the Subcommittee to appear voluntarily before it on May 1 or May 2, 1980 to give testimony.

We are sending a copy of this letter to the Chairman of the Subcommittee. We would also ask that this letter be placed in, and made a part of, the permanent record of the Subcommittee.

Respectfully,

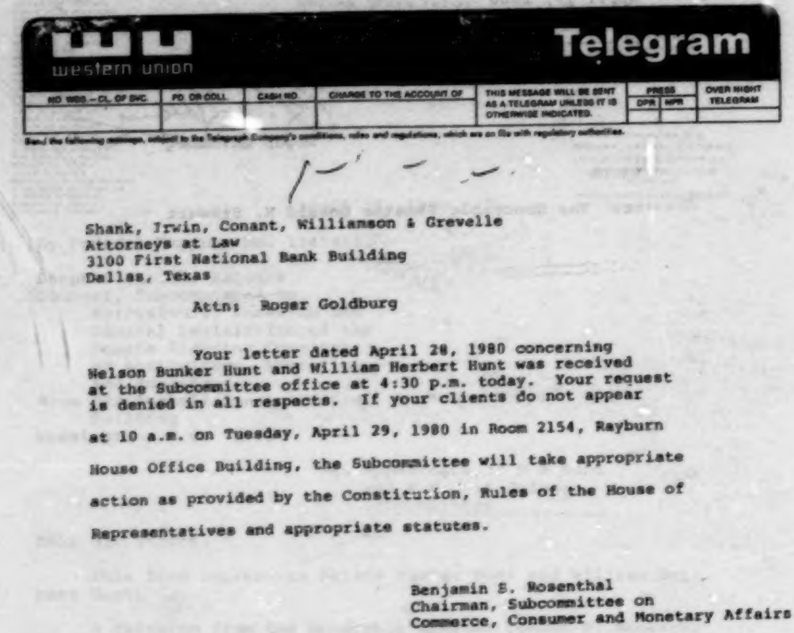
Roger Goldburg

Roger Goldburg

RG:ch

cc: The Honorable Senator Donald W. Stewart

E. BENJAMIN S. ROSENTHAL TELEGRAM TO HUNT ATTORNEYS, APRIL 28, 1980



western union

Telegram

NO. WDS.—CL. OF SVC.	PD. OR COLL.	CASH NO.	CHARGE TO THE ACCOUNT OF	THIS MESSAGE WILL BE SENT AS A TELEGRAM UNLESS IT IS OTHERWISE INDICATED.	PRESS		OVER NIGHT TELEGRAM
					DPR	NPR	

Send the following message, subject to the Telegraph Company's conditions, rules and regulations, which are on file with regulatory authorities.

Shank, Irwin, Conant, Williamson & Grevelle
Attorneys at Law
3100 First National Bank Building
Dallas, Texas

Attn: Roger Goldburg

Your letter dated April 28, 1980 concerning Nelson Bunker Hunt and William Herbert Hunt was received at the Subcommittee office at 4:30 p.m. today. Your request is denied in all respects. If your clients do not appear at 10 a.m. on Tuesday, April 29, 1980 in Room 2154, Rayburn House Office Building, the Subcommittee will take appropriate action as provided by the Constitution, Rules of the House of Representatives and appropriate statutes.

Benjamin S. Rosenthal
Chairman, Subcommittee on
Commerce, Consumer and Monetary Affairs

[illegible]

F. LETTER TO JACK BROOKS FROM BENJAMIN S. ROSENTHAL AND LYLE WILLIAMS, APRIL 29, 1980

NINETY-SIXTH CONGRESS

Congreſs of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

April 29, 1980

Hon. Jack Brooks, Chairman
Government Operations Committee
Room 2157 RHOB
Washington, D. C. 20515

Dear Mr. Chairman:

Please be advised that at a meeting of the subcommittee on Tuesday, April 29, 1980, at which a quorum was present, the subcommittee, by a vote of 6 ayes, 0 nays, adopted the following motion:

"Motion by Representative Deckard

"Mr. Chairman:

"I move that the subcommittee recommend to the full Government Operations Committee that a resolution of contempt be issued by the committee against Nelson Bunker Hunt and William Herbert Hunt and that it be reported to the House of Representatives for a vote thereon."

As you know, on April 22 the subcommittee unanimously authorized the issuance of subpoenas directing Nelson Bunker Hunt and William Herbert Hunt to appear before the Commerce, Consumer and Monetary Affairs Subcommittee at 10 a.m. today in connection with the subcommittee's investigation into the adequacy of the Federal response to recent events in the silver and related financial markets. The subpoenas were authorized after Messers. Hunt refused an April 7 written request to appear voluntarily before the subcommittee.

Notwithstanding the command of the subpoenas, the Hunts failed to appear. In their place, the Hunt's attorney appeared and argued, essentially, that the Hunts are busy people and that the Senate Agriculture Committee, before which they are scheduled to appear voluntarily on Friday, May 2, is a more appropriate forum than the Commerce, Consumer and Monetary Affairs Subcommittee of the House Government Operations Committee.

As a consequence of the Hunt's willful failure to appear, this subcommittee's investigation will be severely damaged. Moreover, the Hunt's default sets a dangerous precedent for the entire House of Representatives.

If the Government Operations Committee and the House fail to cite the Hunts for contempt, no committee of the Congress will be certain of its future ability to enforce subpoenas for persons or documents essential to Congress's investigatory responsibility under the Constitution and the Rules of the House.

Timely action is essential. Accordingly we respectfully request that the contempt resolution approved unanimously by the subcommittee be placed on the agenda for the Government Operations Committee meeting on Wednesday, May 7, for consideration at that time.

Sincerely,

Benjamin S. Rosenthal
Chairman

Lyle Williams
Ranking Minority Member

G. LETTER TO JACK BROOKS FROM HUNT ATTORNEYS, APRIL 29, 1980

SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE
ATTORNEYS AT LAW
3100 FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202
[illegible]
TELECOPIER
[illegible]

April 29, 1980

HAND DELIVERED

The Honorable Jack Brooks
Chairman
Committee on Government Operations
U.S. House of Representatives
2157 Rayburn Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

By our letter of April 28, 1980, we requested the full Committee on Government Operations, as well as the Subcommittee on Commerce, Consumer, and Monetary Affairs, to consider and act upon our timely filed application to vacate and quash certain subpoenas issued to our clients, Nelson Bunker Hunt and William Herbert Hunt.

As you are undoubtedly aware, we appeared this morning before the Subcommittee on Commerce, Consumer, and Monetary Affairs chaired by the Honorable Benjamin S. Rosenthal. We were given an opportunity to present oral argument in favor of our application. We responded to each and every question, consistent with our responsibilities to faithfully represent our clients. At the conclusion of that proceeding, the Subcommittee determined that our clients should be cited for contempt of Congress, notwithstanding the timely filing of our application to vacate and our alternative application for a postponement to a date certain for the presentation of their testimony. We were exceedingly disappointed that we did not have the opportunity to discuss with the Committee, prior to their contempt vote, alternative dates for the presentation of testimony.

We respectfully urge the full Committee to give us the opportunity to appear in order to set forth, in specific fashion, the reasons for our application to vacate and/or quash the instant subpoenas. Alternatively, as we stated in our application on April 28, we are authorized by our clients to arrange for an orderly appearance before the Subcommittee, and we have never, at any stage during our communications between counsel or staff, represented that our clients would not appear. All we have asked for, in the interests of fundamental fairness and due process, is an orderly presentation of the testimony in light of the competing commitments of other Committees and demands and requests of Executive agencies for voluminous documents and other information.

Further, we are authorized by our clients to meet with you and/or Committee Staff to arrange for their appearance before the Subcommittee. Indeed, we are attempting to arrange a meeting with Senator Stewart and his staff this afternoon, wherein we will request that the Senate Agriculture, Nutrition and Forestry Committee adjust our clients' scheduled Friday appearance so that they can appear before Chairman Rosenthal's Subcommittee on Friday.

We would welcome the opportunity to meet with you prior to our appearance before the full Committee if you so grant our request to appear and to present our clients' application to quash and/or vacate or, in the alternative, to schedule another date for the giving of testimony.

We respectfully request that this letter be made part of the record of the full Committee.

Respectfully submitted,

Roger Goldburg

cc: The Honorable Benjamin S. Rosenthal

RG:meg

H. LETTER TO JACK BROOKS AND BENJAMIN S. ROSENTHAL FROM HUNT ATTORNEYS, APRIL 30, 1980

SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE
ATTORNEYS AT LAW
2100 FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202
(214) 748-9696

TELECOPIER
(214) 748-9690

April 30, 1980

HAND DELIVERED

The Honorable Jack Brooks
Chairman
Committee on Government Operations
U.S. House of Representatives
2157 Rayburn Office Building
Washington, D.C. 20515

The Honorable Benjamin S. Rosenthal
Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs
U.S. House of Representatives
B377 Rayburn Office Building
Washington, D.C. 20515

Dear Mr. Chairmen:

Pursuant to my conversation this morning with Staff Director of the Subcommittee on Commerce, Consumer, and Monetary Affairs, Peter S. Barish, Esquire, I wish to confirm for your consideration the following thoughts on behalf of our clients, Nelson Bunker Hunt and William Herbert Hunt, pertaining to the scheduling of their potential testimony before your Subcommittee:

(1) As you know, we timely filed an application to vacate and/or quash the subpoenas issued by the Subcommittee compelling the testimony of our clients before it, which application articulated our clients' position with respect to the subpoenas. Our application was filed directly with the Subcommittee (rather than pursuing alternative courses of action in other forums) to demonstrate our good faith in attempting to work with and through the Subcommittee to provide certain testimony it seeks and, at the same time, give heed to basic considerations of fairness to our clients. I further point out that our clients have not at any point in time refused to appear before the Subcommittee. Rather, they have asked that their testimony be coordinated with testimony to be supplied to other governmental bodies in a manner

that will meet the needs of your Subcommittee and those of other Congressional and Executive bodies seeking information, while at the same time recognizing and protecting the legitimate rights of our clients.

(2) In order to obviate the need for a lengthy, time-consuming proceeding in connection with the matters raised on the record made before the Subcommittee at yesterday's hearing, and to fix a date certain upon which our clients will respond to the subpoenas, I am at liberty to propose for your consideration that our clients appear before the Subcommittee on Friday morning, May 2, 1980.

(3) Our clients have also agreed voluntarily to appear before Senator Stewart's Subcommittee on Friday, May 2, 1980. In a spirit of cooperation between the Senate and House, Senator Stewart has agreed to schedule the time for our clients' appearance before the Senate Subcommittee for the afternoon session of that Subcommittee's hearings commencing at 2:00 p.m. Accordingly, our clients could then appear before your Subcommittee at its morning session in response to the subpoenas. We propose such an appearance. Moreover, should you wish, in your discretion, we would be agreeable to starting those morning proceedings at a time earlier than 10:00 a.m. so as to facilitate the progress of the Subcommittee's business.

(4) We respectfully insist, on behalf of our clients, that all further processes in connection with the Subcommittee's determination to seek contempt sanctions against our clients be terminated.

Our clients will appear and will provide testimony for your Subcommittee. It is our hope that arrangements can be consummated consistent with this proposal.

Respectfully submitted,

Roger Goldberg

Roger Goldburg

By RGL

cc: The Honorable Frank Horton
The Honorable Lyle Williams

RG:meg

bcc: Peter S. Barash, Esquire

I. BENJAMIN S. ROSENTHAL LETTER TO HUNT ATTORNEYS, MAY 1, 1980

BENJAMIN S. ROSENTHAL, N.Y., CHAIRMAN
ROBERT T. MATSUI, CALIF.
EUGENE V. ATKINSON, PA.
FERNAND J. ST GERMAIN, R.I.
JOHN CONYERS, JR., MICH.
ELLIOTT H. LEVITAS, GA.

LYLE WILLIAMS, OHIO
JIM JEFFRIES, KANS.
JOEL DECKARD, IND.

MAJORITY—(202) [illegible]

NINETY-SIXTH CONGRESS
Congress of the United States
House of Representatives
COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

May 1, 1980

Roger Goldburg, Esquire
Shank, Irwin, Conant, Williamson
& Grevelle
1300 - 19th Street, N.W., Suite 210
Washington, D. C. 20036

Paul L. Perito, Esquire
Perito, Duerk, Carlson and Pinco
1140 Connecticut Avenue, N.W.
Washington, D. C.

Gentlemen:

This is in response to Mr. Goldburg's letter of April 30, 1980, and the proposal contained therein.

The Members of the subcommittee agree that if your clients, Nelson Bunker Hunt and William Herbert Hunt, appear and testify before the subcommittee at 9:30 A.M., Friday, May 2, 1980, in Room 2154 Rayburn House Office Building, and if, in the judgment of the subcommittee, your clients testify fully and completely and otherwise cooperate with the subcommittee's investigation, the subcommittee will withdraw its Contempt recommendation against Nelson Bunker and William Herbert Hunt.

It is understood that the appearance of your clients on May 2 is pursuant to the subcommittee's subpoena of April 23, 1980.

Sincerely,

Benjamin S. Rosenthal
Chairman

BSR:bt

J. LETTER TO BENJAMIN S. ROSENTHAL FROM HUNT ATTORNEYS, MAY 1, 1980

Perito, Duerk, Carlson & Pinco, P.C.
Attorneys at Law

PAUL L. PERITO
WILLIAM A. DUERK, III
GLENN R. CARLSON
ROBERT O. PINCO
NATHANIEL E. KOSSACK
JOHN P. WINTROL

ROBERT N. ROSS
C. FREDERICK RYLAND
ELLIOTT B. ADLER
VICTORIA S. MILES
EDWARD JOHN ALLERA

SUITE 400
1140 CONNECTICUT AVENUE, N. W.
WASHINGTON, D. C. 20036
(202) 659-8300
CABLE: VERITAS
TELEX 440346 VTAS

NEW YORK COUNSEL
GODFREY P. SCHMIDT
654 MADISON AVENUE
NEW YORK, NEW YORK 10021
(212) 371-7890

May 1, 1980

The Honorable Benjamin S. Rosenthal
Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs of the
House and Government Operations Committee
B377 Rayburn Office Building
Washington, D.C. 20515

Re: Appearances of Nelson Bunker Hunt and William Herbert Hunt Pursuant to a Committee Subpoena on April 23, 1980

Dear Mr. Chairman:

This letter acknowledges receipt of your letter of May 1, 1980 which was received in this office at approximately 1:00 p.m.

My letter will confirm the oral communications I have had, late this morning and early this afternoon, with your able Staff Director, Peter S. Barash, Esq., wherein I advised him that our clients would appear before your Subcommittee tomorrow morning, May 2, 1980, at 9:30 a.m. in Room 2154 Rayburn House Office Building.

We appreciate your Subcommittee's understanding of our clients' commitment to testify tomorrow afternoon before the Senate Subcommittee on Agriculture, Research and General Legislation of the Senate Standing Committee on Agriculture, Nutrition and Forestry which testimony will commence at 2:00 p.m. It is my understanding that your Subcommittee will allow our clients' a reasonable lunch break prior to the commencement of testimony before the Senate in the afternoon.

Perito, Duerk, Carlson & Pinco, P.C.
Attorneys at Law

This letter will further confirm my understanding with Mr. Barash that our clients will be allowed to make a brief prepared statement prior to the commencement of questions.

I have also had an opportunity to discuss with Mr. Barash our interpretation of the reference in your letter to the wording "and otherwise cooperate with the Subcommittee's investigation". Mr. Barash understands that our clients intend to cooperate with your Subcommittee, consistent, of course, with the preservation of their rights and within the aegis of the rule of pertinence which pertains to the Committee's jurisdiction.

We understand and acknowledge that the appearance of our clients tomorrow morning is pursuant to the subpoena of the Committee of April 23, 1980.

Respectfully yours,

PERITO, DUERK, CARLSON
& PINCO, P.C.

Paul L. Perito

PLP:ijh

K. BENJAMIN S. ROSENTHAL LETTER TO MR. NELSON BUNKER HUNT, WITH QUESTIONS, DATED MAY 9, 1980

[illegible]

NINETY-SIXTH CONGRESS

Congreſs of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE

OF THE

COMMITTEE ON GOVERNMENT OPERATIONS

RAYBURN HOUSE OFFICE BUILDING, ROOM B-377

WASHINGTON, D.C. 20515

[illegible]

May 9, 1980

Mr. Nelson Bunker Hunt
2500 First National Bank Building
Dallas, Texas 75202

Dear Mr. Hunt:

On May 2, 1980, pursuant to a subpoena and under oath you and your brother, William Herbert Hunt, appeared and testified before the Commerce, Consumer, and Monetary Affairs Subcommittee.

Both witnesses agreed to the timely furnishing of data and information to complete the hearing record. The data and information required are described below. All documents and information are to be received by the subcommittee by Monday, June 2, 1980. Answers should follow the exact outline below and should be signed by each witness and notarized.

A. SILVER RELATED ASSETS

1. For each of these dates, August 1, 1979, January 1, 1980, March 28, 1980, and May 2, 1980, state the amount of actual silver in ounces (bullion, coins or any other form) owned or controlled by each of the following persons or entities, and the physical location of the silver. Furnish copies of vault receipts where applicable.

    a. Nelson Bunker Hunt

    b. William Herbert Hunt

    c. Placid Oil (including specific amounts by subsidiaries)

    d. Hunt Energy Corporation (including specific amounts by subsidiaries)

    e. International Metals Investment Co., Ltd. (IMIC) (including specific amounts by subsidiaries)

    f. Profit Investment Company, Inc. (including specific amounts by subsidiaries)

    g. Hunt International Resources Corp.

h. all other trusts, partnerships, associations, private or SEC-unregistered corporations, or other unincorporated organizations or legal entities in which N. B. Hunt, and/or W. H. Hunt, has or receives a direct or indirect beneficial interest or of which N. B. Hunt and/or W. H. Hunt, is an owner, partner, or financial participant.

2. For the same four dates, state the number of silver futures contracts by position, amount, month, and exchange (include overseas transactions), for the persons or entities listed in 1, a-h, above.

3. For the same four dates, set forth outstanding forward contracts, including amounts and form of silver, and parties to the agreement, for the persons and entities listed in 1, a-h, above. Furnish supporting documents or copies.

4. For the same four dates, set forth any other contractual rights to purchase or receive silver, with amounts, for the persons and entities listed in 1, a-h, above.

5. For the same four dates, set forth the nature and extent of the financial interest or investment, including purchase options, in any brokerage firm or any corporation that owns or controls a brokerage firm and the amount of such interests (specify the number of shares in the case of equity investments and, in the case of debt investments, dollar amount and conversion rights, if any) for the persons and entities listed in 1, a-h, above.

6. For the same four dates, set forth the nature and extent of the financial interest or investment, including purchase options, and the amount of such interests (specify the number of shares in the case of equity investments and, in the case of debt investments, dollar amount and conversion rights, if any) in each of the following for persons or entities in 1, a-d, g-h, above.

   i. Gulf Resources and Chemical Corporation
   ii. First Chicago Corp.
   iii. Goldfield Corp.
   iv. Global Marine Inc.
   v. Sunshine Mining Co.
   vi. Louisiana Land and Exploration Co.
   vii. IMIC
   viii. Profit Investment Co.

7. Set forth your relationship, if any, with the following:

   ix. National Commodity and Barter Association

   x. Multi-Projects Ltd.

   xi. American Law Association

B. SILVER RELATED LIABILITIES

For each of the dates listed in A, above, set forth the liabilities, debts, and contractual obligations for the persons and entities in 1, a-h, above in each of the following categories (Note location of creditor located or incorporated abroad).

1. brokerage firms or brokerage firm affiliates, by name, date incurred, amount of the obligation and types and amounts of collateral, if any,

2. banks, by name, amount of obligation and types and amounts of collateral, if any,

3. other persons, corporations, or entities to whom more than $10 million was owed at any one time during 1979 or 1980 to date (including Hunt trusts, corporations, subsidiaries, relatives, etc.), and types and amounts of collateral, if any.

C. BANK LOANS AND LINES OF CREDIT

1. a. List by amount and creditor the liabilities discussed at Boca Raton, Florida, March 30, 1980, reported to have totaled approximately $1.7 billion.

   b. List by name and bank affiliation each bank officer with whom these liabilities were discussed.

2. Describe the partnership between Placid Oil and the Hunt brothers, including the following:

   a. State all terms, conditions, and convenants of the agreement. Furnish supporting documents.

   b. A description and the value or amount of all assets and liabilities transferred or to be transferred into the partnership, by each general partner and each limited partner. Furnish supporting documents.

   c. What restrictions, covenants or agreements are there on assets which Placid Oil contributes to the partnership? Furnish supporting documents.

3. a. Name each bank or other creditor participating in the loans and/or lines of credit extended to Placid Oil since March 28, 1980, the amount contributed to date by each, and the maximum amount each has agreed to make available to Placid Oil.

   b. State the terms, conditions, and convenants of these loans and/or lines of credit. Furnish supporting documents.

Sincerely,

Benjamin S. Rosenthal
Chairman

BSR:tb

cc: Roger Goldburg, Esquire
Shank, Irwin, Conant, Williamson
& Grevelle
3100 First National Bank Building
Dallas, Texas 75202

Paul L. Perito, Esquire
Perito, Duerk, Carlson and Pinco
1140 Connecticut Avenue, N.W.
Washington, D. C. 20036

L. RESPONSES TO QUESTIONS FROM NELSON BUNKER AND WILLIAM HERBERT HUNT, DATED JUNE 4, 1980

SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE
ATTORNEYS AT LAW
3100 FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202
(214) 748-9696
TELECOPIER
(214) 748-6880
TELEX 73-2780

IN WASHINGTON, D.C.
1300 19TH STREET, N.W.
SUITE 310
WASHINGTON, D.C. 20036
(202) 659-8400

[illegible]
A. S. CONANT, JR.
[illegible]
STEVEN C. METZGER
[illegible]
ROY D. WILLIAMSON

[illegible]

[illegible]
CHARLES W. PAULY
WILLIAM D. WRIGHT
J. RICHARD HORNER
JOHN H. PEPER
[illegible]
TIMOTHY W. FULTS
DONALD C. JOHNSON
RICHARD L. ALLEN
[illegible]
JOHN T. HELM

June 4, 1980

Hon. Benjamin S. Rosenthal
Chairman
Commerce, Consumer & Monetary Affairs
Rayburn House Office Building
Room B-377
Washington, D.C. 20515

Dear Mr. Chairman:

This letter is written in response to your letters of May 9, 1980, addressed to our clients, Nelson Bunker Hunt and William Herbert Hunt, in which the Sub-Committee on Commerce, Consumer & Monetary Affairs of the House Government Operations Committee (the "Sub-Committee") requested certain additional information in connection with its inquiry into the operations of the silver futures market.

Our clients have endeavored to respond as fully as possible to the Sub-Committee's requests. It should be noted that much of the information and documents provided have been obtained from Hunt Energy Corporation. For your information, Hunt Energy Corporation is, inter alia, a comprehensive service entity that performs services for many corporate entities and individuals, including some of the entities and individuals from whom the Sub-Committee has requested information. Because much of the information was obtained from Hunt Energy Corporation, our clients cannot insure its accuracy, especially with respect to information pertaining to parties other than themselves.

No responses have been provided for Hunt Energy Corporation. We have been informed that Hunt Energy Corporation has no assets, investments, liabilities or involvement which would be responsive to your questions. Further, we have been advised that Hunt International Resources Corporation had no assets, investments, liabilities or involvement in the silver or silver futures market during the relevant time period of your inquiry.

You will also note that no information is provided for Profit Investment Company, Inc. Profit Investment Company's sole silver-related investment is its fifty percent (50%) ownership position in International Metals Investment Co., Ltd. Accordingly, information pertinent to Profit Investment Company may be discerned from a review of the data for International Metals Investment Co., Ltd.

Information with respect to Placid Oil Company has been previously submitted to the Sub-Committee under separate cover.

The numbered paragraphs below correspond to the numbered paragraphs in your May 9, 1980 letters. Individuals and entities from whom the Sub-Committee has requested information are listed separately.

I. NELSON BUNKER HUNT

A. Silver Related Assets

A-1	8/1/79	1/1/80	3/28/80	5/2/80
Silver Bullion & Silver Coins (Oz.)				
New York (Chase Manhattan, Citibank, Iron Mountain, Irving Trust, Republic National, Swiss Bank Corp.)	3793100	9610400	15837200	9128500
Chicago (Continental Illinois of Chicago, First National Bank of Chicago, Harris Trust)	17155700	17155700	23577300	7706800
New Jersey (Engelhard Minerals & Chemical Corp.)			5930800	-0-
Arizona (North America Coin & Currency)		862700	-0-	-0-
London (Derby & Co., Samuel Montagu; Sharps - Pixley, Johnson-Matthey).			8595000	495000
Total Oz.	20948800	27628800	53940300**	17330300

**According to certain reports, Bache Halsey Stuart Shields, Inc. liquidated 10,236,000 ounces of silver as of the close of business on March 28, 1980, thereby reducing this figure accordingly.

Nelson Bunker Hunt (cont.)

A-2	8/1/79	1/1/80	3/28/80	5/2/80
Silver Futures Contracts				
Comex:				
March, 1980 - Long	11838	12556		
May, 1980 - Long	150	1150	30	
July, 1980 - Short	(2500)	(775)		
July, 1980 - Long				25
Sept., 1980 - Short	(740)	(485)		
Dec., 1980 - Short		(5222)	(1397)	
March, 1981 - Short	(2550)	(308)		
March, 1981 - Long			1003	
	6198	6916	(364)	25
CBOT:				
Feb., 1980 - Long	3030	3100		
April, 1980 - Long	500	521		
Dec., 1980 - Short		(271)		
April, 1981 - Short	(500)	(250)		
	3030	3100		
Total Open Positions Comex & CBOT	9228	10016	(364)	25

A-3	8/1/79	1/1/80	3/28/80	5/2/80
Silver Forward Contracts (Oz.)				
London Metal Exchange				
Merrill Lynch				
March 11, 1980		600000		
March 18, 1980		50000		
April 22, 1980			444000	
April 25, 1980			140000	
July 21, 1980				584000
		650000	584000	584000
ACLI International Commodity Services				
May 6, 1980			1100000	1100000
May 7, 1980			330000	330000
			1430000	1430000
Swiss Bank Corporation-Zurich-Various Dates		750000	3158000	3158000
Total		1400000	5172000	5172000

Nelson Bunker Hunt (cont.)

A-4	8/1/79	1/1/80	3/28/80	5/2/80
Contractual Rights to Purchase Silver				
Naji Robert Nahas (oz. of silver bullion)			1407000	1407000
A-5				
Financial Interest - Brokerage Firm				
Bache Halsey Stuart Shields Inc. Shares of Stock (Common)		157600	288350	288350
A-6				
Financial Interest-Following Companies*				
Global Marine Inc. (Shares of Stock)	217050	217050	213000	100650
IMIC (Non-Convertible Debt)				15000000
Profit Investment Co.				
Shares of Stock (Preferred)	2500	2500	2500	2500
Non-Convertible Debt	5500000	5500000	5500000	5500000

*Nelson Bunker Hunt and Goldfield Corp. entered into an agreement in principle which provided that Nelson Bunker Hunt could purchase a certain number of the shares of Goldfield Corp. for a specified price; further provided that Nelson Bunker Hunt could purchase a 20% interest in a silver mining prospect in New Mexico for a specified price; and granted Nelson Bunker Hunt options for the purchase of an additional 30% interest in the prospect. Mr. Hunt has not exercised any of these rights under the agreement.

A-7

To the best of his knowledge, Nelson Bunker Hunt has no relationship with the National Commodity and Barter Association, Multi-Projects, Ltd., or the American Law Association.

Nelson Bunker Hunt (cont.)

B. Silver Related Liabilities

B-1	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Debts - Brokerage Firms (Outstanding Principal Only)					
Silver Bullion Loans					
ACLI International Inc. - N.Y.					
July, 1976 - Aug. 1979	16529800				
Oct. 1979		39731000	39731000		
Jan. 1980			14064500		
Feb. 1980			9845000		
March, 1980			30014700		
	16529800				2,796,000 oz. Silver Bullion
		39731000			3,131,400 oz. Silver Bullion
			93655200		6,250,400 oz. Silver Bullion
				51155100	7,133,800 oz. Silver Bullion
Bache Halsey Stuart Metal Co. - N.Y.					
Dec. 1973 - Aug. 1979	32010000				
Oct. 1979 -		30000000	30000000		
Jan. 1980			4630300		
Feb. 1980			186000000		
	32010000				4,671,600 oz. Silver Bullion
		30000000			6,362,800 oz. Silver Bullion
			221630300*	-0-	14,760,880 oz. Silver Bullion
E. F. Hutton - N. Y.					
March 1980			87000000*	-0-	6,785,200 oz. Silver Bullion
Mocatta Metals - N. Y.					
Sept. 1976 - March, 1979	24500000	-0-	-0-	-0-	5,182,700 oz. Silver Bullion
Total Silver Bullion Loans	73039800	69731000	402085500	51155100	

*Principal balance prior to liquidation of collateral.

Nelson Bunker Hunt (cont.)

B-1	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Debts - Brokerage Firms (Cont'd)					
Margin Calls					
Heinold Commodities Inc.	-0-		6925600		Treasury Bills 19,250,000
ACLI International	-0-		16049600		*
Merrill Lynch	7400		*		*
Bache Halsey Stuart	125000		*		6250000 oz. Silver Bullion
Paine Webber			15456300		*
Clayton Brokerage Co.	925000				*
Dean Witter Reynolds			8816000		Treasury Bills 8,210,000
A. G. Edwards			5989700		Treasury Bills 1965000
E. F. Hutton			6252200		*
Shearson, Loeb, Rhodes	1195600				*
	2,320000		*		*
Silver Bullion Deliveries					
Bache Halsey Stuart			*		
Total Debts - Brokerage Firms	75359800	69731000	*	51155100	

*Information in dispute; non-verifiable at this time.

B-2 Debts-Banks (Outstanding Principal Only)					
Citibank, N. A.			25000000	17500000	1739 Bags 90% Silver Coins 659 Bags 40% Silver Coins 10 Bags Silver Dallas
Credit Lyonnais, N. Y.	10081000	15000000	15000000	-0-	1125400 oz. Silver Bullion
J. Henry Shroder Bank & Trust Co., N.Y.	5000000	8000000	9000000	-0-	1478400 oz. Silver Bullion
Swiss Bank Corp., N.Y.	35000000	-0-			4954657 oz. Silver Bullion
			100000000		8506708 oz. Silver Bullion
				77388800	8250402 oz. Silver Bullion
First National Bank of Chicago**	10500000	5000000	35000000		
First National Bank in Dallas			18000000	18000000	Various oil & gas leases, stocks, cattle, horses, real property, notes receivable
Total Debts-Banks	60581000	28000000	202000000	112888800	

**Not all of the listed liabilities are silver-related debts.

B-3

Debts-Other Persons**	8/1/79	1/1/80	3/28/80	5/2/80
Placid Oil Company			50,000,000	205,973,800

**Hunt Holdings, Inc. (Pentad Resources, Inc.) owed $10,000,000 during period 3/10/80-3/26/80. Also, in connection with an apparent acquisition of silver from Naji Robert Nahas, partially on credit, a purported obligation to Naji Robert Nahas with respect to that acquisition is in dispute.

C. Bank Loans and Lines of Credit

1a. In general, the liabilities discussed at Boca Raton, Florida on March 30, 1980 were those liabilities set forth in response to Question B above.

1b. To the best knowledge of our clients, the bank officers, by name and bank affiliation, with whom these liabilities were discussed, were as follows:

Willard Butcher	- Chase Manhattan
Dick Thomas	- First National Bank of Chicago
William Spencer	- Citibank
Louis Prestige	- Morgan Guaranty
Bob Stuart, Elvis Mason	- First National Bank in Dallas
Mr. McGillicuddy	- Manufacturers Hanover Trust
W. T. Mundt	- Swiss Bank Corporation
	- Bank of America
	- Chemical Bank
	- Continental Illinois of Chicago

C2. Attached hereto is a copy of an Agreement of Limited Partnership of Placid Investments, Ltd. among Placid Investment Company, as General Partner and Nelson Bunker Hunt, William Herbert Hunt and Lamar Hunt, as Limited Partners. This Agreement is responsive to your questions with respect to the partnership.

C3. Attached hereto is a copy of the Revolving Credit Agreement among Placid Oil Company as Borrower, First National Bank in Dallas and Morgan Guaranty Trust Company of New York as Agents and Thirteen Banks as Lenders. This document is responsive to your questions with respect to the loan arrangements.

II. WILLIAM HERBERT HUNT

A. Silver Related Assets

A-1

Silver Bullion & Silver Coins (Oz.)	8/1/79	1/1/80	3/28/80	5/2/80
New York	4483400	4483400	9645500	7549600
Chicago	16464000	16623200	22873100	17188700
New Jersey			2570000	
Arizona		862700		
London			1450000	
Total Oz.	20947400	21969300	36538600	24738300

William Herbert Hunt (cont.)

A-2	8/1/79	1/1/80	3/28/80	5/2/80
Silver Futures Contracts				
Comex:				
Sept. 1979 - Long	115			
Dec. 1979 - Long	250			
Jan. 1980 - Long	200	250		
March 1980 - Long	330	647		
May 1980 - Long	7114	7379	1203	
July 1980 - Short	(4544)	(4424)	(1846)	(943)
Sept. 1980 - Long		33	33	
March 1981 - Long			25	
May 1981 - Long			336	500
July 1981 - Long				394
	3465	3885	(249)	(49)
CBOT:				
Oct. 1979 - Long	31			
Dec. 1979 - Long	49			
Feb. 1980 - Long	2266	2266		
April 1980 - Short	(1420)	(1360)	(507)	
Dec. 1980 - Long		49	49	
Feb. 1981 - Long				49
	926	955	(458)	49
Total Open Positions - Comex & CBOT	4391	4840	(707)	-0-

A-3				
Silver Forward Contracts (Oz.)				
London Metal Exchange				
Merrill Lynch:				
March 11, 1980		600000		
March 18, 1980		50000		
April 22, 1980			443000	
April 25, 1980			140000	
July 21, 1980				583000
		650000	583000	583000
ACLI International Commodity Services May 6, 1980			330000	330000
Swiss Bank Corporation - Zurich-Various Dates	-0-	750000	3158000	3158000
Total	-0-	1400000	4071000	4071000

William Herbert Hunt (cont.)

A-4	8/1/79	1/1/80	3/28/80	5/2/80
Contractual Rights to Purchase Silver				
Naji Robert Nahas (oz. of silver bullion)			845000	845000
A-5				
Financial Interest-Brokerage Firms				
Bache Halsey Stuart Shields Inc. (Common) Shares of Stock		157600	288250	288250
A-6				
Financial Interest-Following Companies				
Global Marine Inc.				
Shares of Stock (Common)	217050	217050	213000	100650
Profit Investment Co.				
Shares of Stock (Preferred)	2500	2500	2500	2500
Debt Investments (Non-Convertible)	5500000	5500000	5500000	5500000

A-7

To the best of his knowledge, William Herbert Hunt has no relationship with the National Commodity and Barter Association, Multi-Projects Ltd., or the American Law Association.

William Herbert Hunt (cont.)

B. Silver Related Liabilities

B-1 Debts - Brokerage Firms (Outstanding Principal Only)	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Silver Bullion Loans					
ACLI International Inc. - N.Y.					
July, 1976 - Aug. 1979	13309200				
October, 1979		26559800	26559800		
Feb., 1980			10000000		
March, 1980			4043000		
	13309200	26559800	40602800	38102800	2251300 Oz. Silver Bullion 3142300 Oz. Silver Bullion 3881000 Oz. Silver Bullion
Bache Halsey Stuart Metal Co. - N.Y.					
Dec. 1973 - Aug. 1979	3199700				
October, 1979		7000000	7000000		
Feb. 1980			5000000		
	3199700	7000000	12000000**	-0-	580900 Oz. Silver Bullion 4128900 Oz. Silver Bullion
Clayton Brokerage Co. - St. Louis					
October, 1976 - Aug. 1979	37306900	-0-	-0-	-0-	5724700 Oz. Silver Bullion
E. F. Hutton - N.Y.					
March, 1980			13000000**	-0-	2058700 Oz. Silver Bullion
Merrill Lynch - N.Y.					
January, 1980			26000000		
March, 1980			76501200		
			102501200	75777700	8219600 Oz. Silver Bullion
Mocatta Metals					
Sept., 1976 - March, 1979	25900000	-0-	-0-	-0-	5529100 Oz. Silver Bullion
Total	79715800	168104000	16810400	113880500	

**Principal balance prior to liquidation of collateral.

William Herbert Hunt (cont.)
Silver Related Liabilities

B-1	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Debts - Brokerage Firms (Cont'd)					
Margin Calls					
Merrill Lynch			*		*
Bache Halsey Stuart			*		316600 oz. Silver Bullion
Paine Webber			10237000		
Cargill Investor Services			1919600		
ACLI International			3712900	4070200	
Dean Witter Reynolds			8348900		Treasury Bills 7,900,000
Clayton	57100				
Total	57100		24218400		
Total Debts - Brokerage Firms	79772900	33559800	192322400	117950700	

*Information in dispute; non-verifiable at this time.

B-2 Debts- Banks (Outstanding Principal Only)	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Citibank, N. A. - N.Y.			25000000	17500000	1739 Bags 90% Silver Coins
					659 Bags 40% Silver Coins
					10 Bags Silver Dollars
					1300600 oz. Silver Bullion
Credit Lyonnais - N.Y.			15000000	-0-	1043300 oz. Silver Bullion
Swiss Bank Corp. - N.Y.	35000000	-0-			6483100 oz. Silver Bullion
			100000000		10112600 oz. Silver Bullion
				89468000	9538170 oz. Silver Bullion
First National Bank in Dallas			2000000	2000000	Oil, gas & coal leases, stocks, real property, notes receivable
First National Bank of Chicago	19500000	5000000	15000000	-0-	
Total Debts - Banks	54500000	5000000	157000000	108968000	

B-3 Debts - Other Persons (Outstanding Principal Only) **	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Nelson Bunker Hunt			40500000	50000000	
Placid Oil Company			55000000	135088600	
Total Debts - Others			95500000	185088600	

**Hunt Holdings, Inc. (Pentad Resources, Inc.) owed $10,000,000 from period 3/10/80-3/26/80.
Also, in connection with an apparent acquisition of silver from Naji Robert Nahas, partially on credit, a purported obligation to Naji Robert Nahas with respect to that acquisition is in dispute.

William Herbert Hunt (cont.)

C. Bank Loans and Lines of Credit

See responses of Nelson Bunker Hunt.

III. INTERNATIONAL METALS INVESTMENT CO., LTD.

A. Silver Related Assets

	8/1/79	1/1/80	3/28/80	5/2/80
A-1 Silver Bullion & Silver Coins				
New York		5643000	4625000	4170000
Chicago		4804000	4203000	4203000
Various U. S. Banks		7537000	7537000	7537000
London		10030000	6164000	6164000
Zurich		8991000	9496000	7061000
		3700500	32025000	29135000
A-2 Silver Futures Contracts				
Comex:				
Sept, 1979 - Long	50			
Dec., 1979 - Long	261			
May, 1980 - Long		881	367	
July, 1980 - Long	200	1000	727	
		135	135	105
Sept., 1980 - Long	511	2016	1229	105
CBOT:				
Oct., 1979 - Long	75			
Dec., 1979 - Long	296			
April, 1980 - Long		576	431	
June, 1980 - Long	200	990	990	146
Aug., 1980 - Long		226	226	226
	571	1792	1647	372
Total Open Positions - Comex and CBOT	1082	3808	2876	477
A-3 Silver Forward Contracts (Oz.)				
London Metal Exchange				
Merrill Lynch				
March 11, 1980		600000		
March 18, 1980		50000		
April 22, 1980			443000	
April 25, 1980			140000	
		650000	583000	

International Metals Investment Co. Ltd. (cont.)

	8/2/79	1/1/80	3/28/80	5/2/80
ACLI International Commodity Services				
May 6, 1980			330000	
Swiss Bank Corporation-Zurich				
May 14, 1980			333000	333000
May 19, 1980			117000	117000
June 3, 1980			83000	83000
			533000	533000
Mocatta Metals Corporation - New York				
Jan. 4, 1980		140000		
Jan. 21, 1980		70000		
Jan. 31, 1980		150000		
Feb. 4, 1980		85000		
Feb. 29, 1980		150000		
Mar. 3, 1980		65000		
Mar. 31, 1980		150000	150000	
April 1, 1980		40000	40000	
April 30, 1980		150000	150000	
May 5 through Dec. 31, 1980		4178000	4178000	4178000
		5178000	4518000	4178000
		5828000	5964000	4711000

International Metals Investment Co., Ltd. (cont.)

B. Silver Related Liabilities

	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
B-1					
Debts - Brokerage Related (Outstanding Principal Only)					
Merrill Lynch	-0-	50000000			4,590,000 oz. Silver Bullion;
			287750000		146,100,000 oz. Silver Bullion; Coins; 3200 oz. Gold; Treasury Bills of 166,000,000
				199529000	13,080,000 oz. Silver Bullion; Coins; 3200 oz. Gold; Treasury Bills of 44,000,000
B-2					
Bank Debt-Silver Related (Outstanding Principal Only)					
Schroder Bank-Zurich		10000000	20000000	20000000	2,367,400 oz. Silver Bullion
Bank Arab International Inc.-Paris			10000000	10000000	1,435,500 oz. Silver Bullion
Saudi Finance Corporation-Paris			26000000		2,468,500 oz. Silver Bullion
Bank Leu-Zurich			50000000	21401000	2,783,750 oz. Silver Bullion
Citibank-New York		25000000	40000000	40000000	2,580,000 oz. Silver Bullion
Swiss Bank Corporation		150000000			3,185,000 oz. Silver Bullion
First National Bank-Dallas			15000000		Guaranteed by N. B. Hunt
		185000000	161000000	91401000	
B-3					
Other Debts-Silver Related (Outstanding Principal Only)					
Mocatta Metals Corporation		25482060	17677000	13855550	Silvrr Forwards Contracts
Various U.S. Banks on Coin Options		12003000	12003000	12003000	Silver Coins
N. B. Hunt				15000000	
Subordinated Loans from Shareholders	20000000	20000000	20000000	20000000	
	20000000	57485060	49680000	60858550	

IV. HUNT INTERNATIONAL MINERALS LTD.

A. Silver Related Assets

A-1	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Silver Bullion (Oz.)					
New York	504900	504900	504900	-0-	
A-2					
Silver Futures Contracts					
Comex:					
May 1980	54	54	-0-	-0-	

B. Silver Related Liabilities

B-1	8/1/79	1/1/80	3/28/80	5/2/80	Collateral
Debts - Brokerage Firms (Outstanding Principal Only)					
Silver Bullion Loans					
Bache Halsey Stuart Metal Co., March 1975-Aug. 1979	2759300	2759300	-0-	-0-	504900 Oz. Silver Bullion
Margin Calls					
Bache Halsey Stuart Shields, N.Y.			*		
Total Debts - Brokerage Firms	2759300	2759300	*	-0-	

*Information in dispute; non-verifiable at this time.

V. PLANET INVESTMENT CORPORATION

A. Silver Related Assets

A-1	8/1/79	1/1/80	3/28/89	5/2/80
Silver Bullion (oz.)				
Swiss Bank Corporation	3,000,000	3,000,000	3,000,000	
First of Chicago, Continental Illinois Bank				3,003,359.19

Planet Investment Corp. (cont.)

B. Silver Related Liabilities

Planet Investment Corporation has a non-silver related obligation to Manufacturers Hanover Trust Company which is secured by substantially all of its assets, including the 3,000,000 ounces of silver bullion, and such obligation is further guaranteed by N. B. Hunt and W. H. Hunt.

The foregoing information submitted to you on behalf of our clients is based upon their best knowledge and information available to them at this time. While our clients believe that the information set forth in this letter is accurate, they, nevertheless cannot at this time confirm or insure either its accuracy or completeness. This is so because:

(a) the information was compiled from data secured primarily from third parties;

(b) the information was gathered by persons other than our clients, and

(c) the time frame within which the information was gathered was limited.

The foregoing information, together with copies of the agreements attached hereto, should satisfy the questions raised in your May 9, 1980 letters. Please consider this information as confidential and intended solely for the purposes and use of your Sub-Committee.

Respectfully submitted,

Roger Goldburg

RG:hm

cc: N. B. Hunt
W. H. Hunt

best copy available

M. RESPONSES TO QUESTIONS FROM PLACID OIL COMPANY, DATED MAY 30 AND JUNE 2, 1980

SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE
ATTORNEYS AT LAW
3100 FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202
(214) 748-9696
TELECOPIER
(214) 748-9690
TELEX 73-2780

IN WASHINGTON, D.C.
1300 19TH STREET, N.W.
SUITE 510
WASHINGTON, D.C. 20036
(202) 659-9400

KAREN S. BEDELL
CECIL W. CASTERLINE
A. B. CONANT, JR.
ROBERT B. COUSINS, JR.
WILLIAM E. DOUGLASS
ROGER GOLDBURG*
JAMES V. GREVELLE
IVAN IRWIN, JR.
STEVEN C. METZGER
ROCKNEY D. PLETCHER
FREDERICK J. REMBO
ROBERT H. RULE, JR.
RALPH B. SHANK
ALLEN WEED
RAY B. WILLIAMSON

*LICENSED IN COLORADO
AND NEW YORK ONLY

WILLIAM D. HAYWARD
JOHN R. WOODWARD
EVAN M. BOTTING
DREW B. HEARD
CHARLES W. PAULY
WILLIAM D. WRIGHT
RODERIC G. STEAKLEY
J. RICHARD HORNER
JOHN H. PEPER
KATHLEEN S. CLEAVELAND
P. TALMAGE BOSTON, JR.
TIMOTHY M. FULTS
DONALD C. JOHNSON
RICHARD L. ALLEN
WILLIAM B. CHANEY
THOMAS I. HISIER
JOHN T. HELM

June 2, 1980

The Honorable Benjamin S. Rosenthal
Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs of the
House and Government Operations Committee
B377 Rayburn Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

In connection with your letters of May 9, 1980, addressed to Mr. Nelson Bunker Hunt and Mr. William Herbert Hunt, requesting certain information pertaining to the Subcommittee's Inquiry into silver futures contract matters, you will find enclosed a partial response based upon information received from Paul W. Hicks, Secretary and General Counsel for Placid Oil Company. This information addresses certain questions applicable to Placid Oil Company.

At the request of Mr. Hicks, we urge that this information be held confidential.

Respectfully,

Roger Goldburg

RG:mm
Enc.

cc: Peter S. Barish, Esquire
E. Barrett Prettyman, Jr., Esquire
Paul L. Perito, Esquire

PLACID OIL COMPANY
1600 FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202

May 30, 1980

Mr. Nelson Bunker Hunt
2500 First National Bank Bldg.
Dallas, Texas 75202

Dear Mr. Hunt:

You have furnished the officers of Placid Oil Company ("Placid") a copy of the May 9, 1980 letter (the "Request Letter") to you from Benjamin S. Rosenthal, Chairman of the Commerce, Consumer and Monetary Affairs Subcommittee (the "Subcommittee") of the Committee on Government Operations of the House of Representatives and have requested that Placid furnish you the data, information or documents called for by the Request Letter insofar as they relate to Placid and its subsidiaries.

Please be advised that the Custodian of Records of Placid has made, or caused to be made, a diligent and careful search of the records, documents and information in his custody, possession or control and has caused to be prepared the data and information, and has caused to be produced the documents, set forth or described below.

Data and information given or documents described herein are grouped under the alphabetical and numberical categories set forth in the Request Letter. Where a document is described, a true and correct copy of that document is attached hereto. The data and information furnished and documents described are from the dates mentioned in the Request Letter through May 9, 1980, the date of the Request Letter. No information or documents subsequent to May 9, 1980 are furnished or described. Where an item in the Request Letter is not responded to, the answer is in the negative or the question is not applicable to Placid and its subsidiaries. Following is all such data and information, and a description of documents, which are in the opinion of the Custodian of Records of Placid called for by the Request Letter as to Placid and its subsidiaries.

A. 2. Information with respect to silver futures contracts for Eighth Crescent Investment Company, an indirect wholly-owned subsidiary of Placid:

Date	Position	Number of Contracts	Delivery Month	Exchange
August 1, 1979	None	-	-	-
January 1, 1980	None	-	-	-
March 28, 1980	Long	125	December 1980	Comex
May 2, 1980	Long	125	December 1980	Comex

A. 6. Financial interest in or investment by Placid (through indirect wholly-owned subsidiaries) with respect to:

i. Gulf Resources and Chemical Corporation.

Date	Aggregate Number of Shares Owned	Aggregate Cost of Investment
August 1, 1979	None	None
January 1, 1980	687,500	$ 13,072,587
March 28, 1980	806,100	15,591,977
May 2, 1980	806,100	15,591,977

vi. Louisiana Land and Exploration Company.

Date	Aggregate Number of Shares Owned	Aggregate Cost of Investment
August 1, 1979	1,850,000	$ 54,139,837
January 1, 1980	3,498,600	130,604,541
March 28, 1980	3,498,600	130,604,541
May 2, 1980	3,498,600	130,604,541

B. 1. Silver related liabilities, debts and contractual obligations of Placid and its subsidiaries to brokerage firms or brokerage firms' affiliates:

None, except price differential obligations of Eighth Crescent Investment Company, an indirect wholly-owned subsidiary of Placid, under Comex rules with respect to 125 silver futures contracts referred to under paragraph A. 2. above (Broker: Merrill Lynch Pierce Fenner & Smith Inc.).

C. 2. Partnership arrangements.

Partnership Commitment Letter, dated April 30, 1980 between Placid and N. B. Hunt, W. H. Hunt and Lamar Hunt. (Copy attached).

C. 3. Bank or other creditors participating in actual loans and/or lines of credit to Placid between March 28, 1980 and May 9, 1980.

Name of Bank	Amount Loaned	Date
Citibank, N.A.	$25,000,000(1)	March 31, 1980
Citibank, N.A.	40,000,000(1)	April 1, 1980
First National Bank in Dallas	3,750,000(2)	April 8, 1980
Citibank, N.A.	56,250,000(2)	April 8, 1980
Chemical Bank	18,750,000(2)	April 8, 1980
Bank of America, N.T.S.A.	37,500,000(2)	April 8, 1980
Continental Illinois National Bank	26,250,000(2)	April 8, 1980
The First National Bank of Chicago	26,250,000(2)	April 8, 1980
Manufacturers Hanover Trust Co.	37,500,000(2)	April 8, 1980
Chase Manhattan Bank, N.A.	56,250,000(2)	April 8, 1980
Morgan Guaranty Trust Co. of N.Y.	37,500,000(2)	April 8, 1980
Morgan Guaranty Trust Co. of N.Y.	5,000,000(3)	April 28, 1980
Chase Manhattan Bank, N.A.	5,000,000(3)	April 28, 1980
Manufacturers Hanover Trust Co.	5,000,000(3)	April 28, 1980

(1) $50,000,000 repaid April 3, 1980. Copies of Advice of Credits and Debit attached.
(2) Copy of Interim Demand Note attached.
(3) Advanced pursuant to a $10,000,000 line of credit for working capital. Copy of commitment letter attached and note attached.

Additionally, there was executed a Bank Commitment Letter, dated May 1, 1980, between Placid and First National Bank in Dallas, as Lender and as Agent, Morgan Guaranty Trust Company of New York, as Lender and as Agent, and eleven other Banks, relating to $1,100,000,000 of loans to Placid. (Copy attached).

- - - - - - - - - - - - - - - -

If you so desire, you are authorized to deliver a copy of this letter and copies of the documents delivered herewith, or to give the information set forth herein, to the Subcommittee; however, since you and William Herbert Hunt are neither officers, directors or shareholders of or agents for Placid or any of its subsidiaries, this letter (except as set forth herein) does not authorize you to act or respond on behalf of Placid and its subsidiaries.

Very truly yours,

Paul W. Hicks

Paul W. Hicks,
Secretary and General Counsel,
Custodian of Records

SUBSCRIBED AND SWORN TO BEFORE ME this 31st day of May, 1980, to certify which witness my hand and seal of office.

Jean C. Ricketts
Notary Public in and for Dallas County, Texas

Notary Public in and
for Dallas County, Texas
My Commission Expires 6-28-81

N. LETTER TO BENJAMIN S. ROSENTHAL FROM HUNT ATTORNEYS, DATED JUNE 19, 1980

SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE
ATTORNEYS AT LAW
2100 FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202
(214) 748-8888
TELECOPIER
(214) 748-8880
TELEX 73-0780

IN WASHINGTON, D.C.
1800 19TH STREET, N.W.
SUITE 810
WASHINGTON, D.C. 20036
(202) 659-6406

KAREN S. BEDELL
CECIL W. CASTERLINE
A. B. CONANT, JR.
ROBERT B. COUSINS, JR.
WILLIAM E. DOUGLASS
ROGER GOLDBURG*
JAMES V. GREVELLE
TOM IRWIN, JR.
STEVEN C. METZGER
RODNEY D. FLETCHER
FREDERICK J. REMMO
ROBERT H. RULE, JR.
RALPH B. SHANK
ALLEN WEED
RAY G. WILLIAMSON

*LICENSED IN COLORADO AND NEW YORK ONLY

WILLIAM D. HAYWARD
JOHN P. WOODFORD
EVAN H. BOTTING
DREW R. HEARD
CHARLES W. DAILY
WILLIAM B. WRIGHT
RODERIC G. STEAKLEY
J. RICHARD HORNER
JOHN H. PEPER
KATHLEEN S. CLEAVELAND
P. TALMADGE BOSTON, JR.
TIMOTHY M. PULTS
DONALD C. JOHNSON
RICHARD L. ALLEN
WILLIAM B. CHANEY
THOMAS I. HIRSCH
JOHN T. HELM

June 19, 1980

HAND DELIVERED

Honorable Benjamin S. Rosenthal
Chairman
Commerce, Consumer & Monetary Affairs
Subcommittee of the Committee on
Government Operations
Rayburn House Office Building
Room B-377
Washington, D. C. 20515

Re: Investigation of House Subcommittee into Recent Events in Silver Market

Dear Mr. Chairman:

On behalf of our client, William Herbert Hunt, we submit this letter to the Subcommittee to clarify the record before it.

On May 2, 1980, the following question was asked of Mr. Hunt at the Subcommittee hearing: "[I]n October of 1979, did you or do you know if any of your colleagues transferred silver to vaults in London through the use of warehouse receipts?" (Transcript, May 2, 1980, page 73, at lines 1794-96). Mr. Hunt responded: "You are asking me if I took silver from this country to London?" (Transcript, May 2, 1980, page 74, at lines 1804-05). Chairman Rosenthal: "[This] is what I am asking you." Mr. Hunt: "The answer is no." (Transcript, May 2, 1980, page 74, at lines 1806-07). Subsequently, the Chairman asked: "We must have from both of you, Mr. Hunts, an accurate response as to how much silver subject to the use of warehouse receipts you transferred out of this country at any time." W. H. Hunt replied, "I have transferred no silver out of the country." (Transcript, May 2, 1980, page 75, at lines 1839-44). These responses, within the context of the line of questioning, were entirely accurate.

The transcript of testimony taken from Bill Bledsoe on May 23, 1980 (the "Bledsoe deposition") refers to Bledsoe's hearsay "understanding that the Hunts had many planeloads of silver flown from New York City and Chicago to Switzerland containing silver" (Bledsoe deposition, page 34). Neither W. H. Hunt nor N. B. Hunt had a recollection of physical shipments of silver to Switzerland, or, for that matter, anywhere abroad. In an exercise of caution, however, a search of records was undertaken last week to confirm these particular matters. No documentary evidence appears to reflect any shipment of physical silver from the United States to Switzerland (and Mr. Bledsoe's "understanding" appears to be in error). Documentation has been discovered that indicates that in July, 1975, approximately five years ago, 6,000,000 ounces of silver were delivered by cargo plane from this country to London over a ten-day period. The apparent purpose of this shipment was to make silver available for potential delivery pursuant to "short" silver contracts on the London futures exchange in 1975.

The transcript of the Bledsoe deposition recites that Mr. Bledsoe's testimony was taken "for the purpose of clarifying and completing the record before the Subcommittee." (Bledsoe deposition, page 3, at lines 19-21.) We regret that, for the purpose of clarifying and completing the record, the Subcommittee did not take the additional step of permitting our client to comment on Mr. Bledsoe's testimony to the same extent that Mr. Bledsoe was permitted to comment on the testimony of Messrs. W. H. Hunt and N. B. Hunt.

Our client denies Mr. Bledsoe's unfounded allegation that W. H. Hunt intended to mislead, or did mislead, the Subcommittee in his testimony before it on May 2, 1980 (see Bledsoe deposition, page 16, at lines 23-25 and page 17, at lines 1-2). Further, our client stands upon his testimony before the Subcommittee in each and every instance where there is a real or apparent conflict between his testimony and the testimony of Mr. Bledsoe.

This letter is delivered to the Subcommittee to further the objective of a full and complete record before it, and to preclude distortions based upon unexamined assertions by Mr. Bledsoe, who, as you know, is involved in litigation with Hunt Energy Corporation relating to matters arising out of his past employment with it.

Further, in light of your letter to Benjamin R. Civiletti, Attorney General of the United States, dated June 10, 1980, we feel it appropriate to send a copy of this letter to Mr. Civiletti's office.

Respectfully,

Roger Goldburg
Shank, Irwin, Conant, Williamson &
Grevelle
Attorneys for William Herbert Hunt

RG:mm

cc: Honorable Benjamin R. Civiletti
Attorney General
Department of Justice
Washington, D.C. 20530

Honorable Lyle Williams
Subcommittee on Commerce, Consumer
and Monetary Affairs
1004 Longworth House Office Building
Washington, D.C. 20515

APPENDIX 2.—SUBPENA MEETING, APRIL 22, 1979

A. BUSINESS MEETING TRANSCRIPT, APRIL 22, 1979, WITH SUBPENAS

SILVER PRICES AND THE ADEQUACY OF FEDERAL ACTIONS IN THE MARKETPLACE, 1979–80

TUESDAY, APRIL 22, 1980

House of Representatives,
Subcommittee on Commerce, Consumer, and Monetary Affairs
of the Committee on Government Operations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 11:30 a.m., in room 2154, Rayburn House Office Building, Hon. Benjamin S. Rosenthal (chairman of the subcommittee) presiding.

Present: Representatives Benjamin S. Rosenthal, Robert T. Matsui, Elliott H. Levitas, Lyle Williams, and Joel Deckard.

Staff present: Peter S. Barash, staff director; Stephen R. McSpadden, counsel; Barbara Timmer, counsel; Donald P. Tucker, chief economist; Andrew Savitz, professional staff member; Eleanor M. Vanyo, secretary; and Jack Shaw, minority counsel, Committee on Government Operations.

Mr. Rosenthal. The subcommittee will come to order.

We will begin, and we will delay votes until other members who are expected will come.

Today's meeting of the Commerce, Consumer, and Monetary Affairs Subcommittee has been called to consider the issuance of several subpenas for the production of persons and/or documents essential to ongoing subcommittee investigations.

I will first turn to the subcommittee oversight authority.

The Rules of the House of Representatives assign to the Government Operations Committee specific responsibility for:

One, investigating the "economy and efficiency of government operations and activities . . . at all levels"—rule X, clause 1 and 2.

Two, reviewing and studying "on a continuous basis, the application, administration, execution and effectiveness of those laws . . . and the organization and operation of the Federal agencies and entities having responsibilities in or for the administration and execution thereof"; and,

Three, "receiving and examining reports of the Comptroller General of the United States and of submitting such recommendations to the House as it deems necessary or desirable in connection with the subject matter of such reports"—rule X, clause 4.

Moreover, clause 4 of House Rule X states that:

"In addition to its duties under subparagraph (1), the Committee on Government Operations may at any time conduct investigations of any matter without regard to the provisions of clause 1, 2, or 3 (or this clause) conferring jurisdiction over such matter upon another standing committee.

"The committee's findings and recommendations in any such investigation shall be made available to the other standing committee or committees having jurisdiction over the matter involved."

And I emphasize "shall" be made available.

I turn now to the subcommittee jurisdiction and subpena authority.

When the Government Operations Committee held its organizational meeting for the 96th Congress, the Commerce, Consumer, and Monetary Affairs Subcommittee was duly established and its jurisdiction fixed.

The subcommittee was specifically assigned oversight responsibility for the operations and activities of the Commodity Futures Trading Commission.

Rule XI, 2(m)(1) of the House Rules states that:

"For the purpose of carrying out any of its functions and duties under this rule and Rule X . . . any committee or any subcommittee thereof is authorized . . . to require, by subpena or otherwise, the attendance and testimony of such witness and the production of such books, records, correspondence, memorandums, papers and documents as it deems necessary. . . .

"A subpena may be authorized and issued by a committee or subcommittee under subparagraph (1)(B) in the conduct of any investigation or series of investigations or activities, only when authorized by a majority of the members voting, a majority being present."

I would like to discuss the background of the silver market issue.

For sometime now, this subcommittee has been conducting an in-depth investigation of the operations and activities of the Commodity Futures Trading Commission, in order to determine whether that agency is performing its statutory responsibilities in an efficient and effective manner.

Most recently, the subcommittee has been examining, and has already held 3 days of hearings on, the Federal response to the recent collapse of the silver market.

The collapse of the silver futures market—regulated by the CFTC—had a serious impact on securities markets and on other financial markets regulated by such Federal agencies as the SEC, the Federal Reserve Board, and the Department of the Treasury.

The subcommittee's hearings have already demonstrated that there is great concern over the ability of the Federal regulatory apparatus to properly deal with the domino effect of the collapse of one market on another.

The Commodity Exchange Act states that because commodity prices are susceptible to speculation, manipulation, and control and sudden or unreasonable fluctuations in the prices frequently occur as a result, which are detrimental to the producer or the consumer, regulation is imperative to prevent an undue burden on interstate commerce.

We have been told, as early as July 1979, the Commodity Futures Trading Commission knew of large silver positions by a handful of speculators. It became increasingly apparent during the fall that potential deliveries on February and March silver contracts were contributing to rapid price increases in the underlying commodity and volatility in all the metal markets.

Yet, testimony at our hearings to date shows the CFTC took little or no actions of its own, pressured by the exchanges on the one hand and large traders on the other.

Accordingly, additional data from the CFTC is essential if we are to have a complete record of its performance as to events in the silver markets.

Moreover, the activities of Nelson Bunker Hunt and William Herbert Hunt figured prominently in the March silver market collapse. The Hunts have information essential to our investigation—information about their silver dealings and about their relationships with Federal regulatory agencies and Federal regulatory officials.

We know from documents and other information made available to the subcommittee that the Hunts may have attempted to corner the silver markets; and actively intervened in the Federal regulatory process and in the self-regulating activities of the commodity exchanges.

The Hunts have refused to appear voluntarily before this subcommittee. If our investigation into the adequacy of the Federal response to events in the silver markets is to be complete; and if we are to fulfill our oversight responsibility to examine the effectiveness of Government operations and make timely findings and recommendations to other standing committees of the House, their testimony is essential.

I turn now to subpenas for silver markets investigation.

We will first consider subpenas for Nelson Bunker Hunt and William Herbert Hunt to compel their appearance April 29, 1980, Room 2154, Rayburn Building, at 10 a.m.

Supporting documents for your information include:

One, request to the Hunts to testify, dated April 7, 1980.

Two, response from the Hunts' attorney, dated April 11, 1980.

Three, documents from Commissioner Dunn of the Commodity Futures Trading Commission, two packets, dated April 15 and April 17, 1980, which detail numerous conversations and meetings between the Hunts and staff and Commissioners of the CFTC between October 1979 and January 1980.

And, four, opening statements from the first three days of subcommittee hearings on the silver markets, March 31, April 14 and 15, 1980.

Nelson Bunker Hunt and his brother William Herbert Hunt figure prominently in the March silver markets collapse. They are among the handful of major traders who used the futures exchanges to actually take physical delivery of silver and may have thereby affected not only the price of the metal but volatility of futures trading.

Other major silver buyers during this period include Conticommodity Services, Incorporated, the brokerage arm of Continental Grain, the Soviet-owned Wozchod Bank of Zurich, and several West German and Swiss banks which act for larger international—anonymous—investors.

The documents from Commissioner Dunn raise important questions about the regulatory decisionmaking process of the CFTC:

To what extent do large traders like the Hunts affect or influence the agency's regulatory decisions?

How legitimate are the Hunts' claims that various exchange actions profitted Exchange members who held large short positions?

Has the conversion of the metals futures markets into markets for acquiring the physical commodities destroyed the economic purpose of those contracts?

These questions, as well as those set forth initially in our April 7, 1980, letter to the Hunts, must be answered if our investigation is to be complete. Our study of Federal regulatory effectiveness in the marketplace will be incomplete without information and testimony from the traders reputed to have cornered the underlying commodity.

We had originally written to them on April 7, 1980, addressed to Mr. Herbert Hunt and Mr. Nelson Bunker Hunt at 2500 First National Bank, Dallas, Texas 75202, with a whole series of inquiries and a request to appear before the subcommittee.

We received a letter from a law firm by the name of Shank, Irwin, Conant, Williamson and Grevelle, Attorneys at Law, 3100 First National Bank Building, Dallas, Texas 75202.

It indicates they were willing to discuss this matter and they request this. Let me read the letter. It is dated April 11, 1980, and is addressed to me.

"This firm represents Mr. Nelson Bunker Hunt and Mr. William Herbert Hunt.

"This letter is in response to a telegram from you addressed to our clients, dated April 7, 1980, requesting their appearing before the Commerce, Consumer and Monetary Affairs Subcommittee of the United States House Committee on Government Operations (the "Subcommittee") to testify on a variety of topics delineated in that telegram.

"Since the receipt of the telegram by our clients, I have had several conversations with counsel for the Subcommittee, Ms. Barbara Timmer. I have explained to Ms. Timmer that our clients wish to cooperate with the Subcommittee.

"On the other hand, I am sure you can recognize that the scope of the matters upon which the Subcommittee desires to inquire is extensive and complex. As I have previously explained to Ms. Timmer, it is virtually impossible for our clients to evaluate your request and to prepare properly for any such appearance on the limited notice afforded by the telegram.

"Ms. Timmer has requested a date certain upon which our clients would be available to appear before the Subcommittee. I have been unable to talk with either of them concerning such a commitment.

"I have, therefore, advised Ms. Timmer that I shall contact her early next week to discuss a potential date for such appearance.

"We would respectfully request that this letter be made a part of the permanent record of your Subcommittee.

"Respectfully, Robert B. Cousins, Jr."

Without objection, a copy of our letter of April 7, 1980, and the response of April 11, 1980, will be inserted in the record at this point.

[Letters of April 7, 1980 and April 11, 1980 follow:]

CHARGE NO. GHA-082024

April 7, 1980

Mr. Herbert Hunt
Mr. Nelson Bunker Hunt
2500 First National Bank
Dallas, Texas 75202

The Commerce, Consumer and Monetary Affairs Subcommittee (U.S. House Committee on Government Operations) requires your appearance and testimony at hearings into the Federal Government's response to recent events in the silver markets and the impact of those events on the securities and other financial markets. The hearing will be held on Monday, April 14, 1980, Room 2247 of the Rayburn House Office Building, Washington, D.C., at 10 A.M.

In view of your involvement in these markets and media reports of your attempted corner on silver, we need your testimony as to the following:

What triggered the market movements during the week ending March 28, 1980?

How do foreign markets compare with American exchanges, particularly COMEX and CBOT?

Did any actions taken by these two exchanges contribute to the markets' disruption?

Has Federal Reserve policy, including the recent series of rapid prime rate increases, impacted the futures markets? The value of physical silver?

How have the policy and practices of the Commodity Futures Trading Commission (CFTC) affected silver futures trading? Are there any recommendations you would make to the CFTC?

How has Securities and Exchange Commission (SEC) policy affected the silver markets?

What information on foreign traders and commodities should be available to the CFTC?

What kinds of futures trading are moving out of the United States?

What might be the effects of this movement? Describe the self-regulatory mechanism of the London exchange.

Can speculative money ever be a danger in the futures market? Should there be limits on the amount of a commodity controlled by any one speculator?

Paul Sarnoff of Conticommodity Services, Inc., described your silver trading as a "classic tax straddle". Would you comment?

Describe your relationship with the Bache Groupe, Inc., including subsidiaries, Engelhard Minerals and Chemical Company, Gulf Resources and Chemical Corporation, and Sunshine Mining.

What additional recommendations would you make as an individual trader to the Congress and Federal regulatory agencies which share jurisdiction for the financial markets?

Although the Rules of the House of Representatives give the subcommittee subpoena authority, we would prefer your voluntary cooperation in our efforts to provide a full and complete hearing record.

If there are any questions regarding this request, please contact Peter Barash, staff director of the subcommittee, or Barbara Timmer, counsel to the subcommittee, on 202-225-4407.

Benjamin S. Rosenthal
Chairman
Commerce, Consumer and
Monetary Affairs Subcommittee

SHANK, IRWIN, CONANT, WILLIAMSON & GREVELLE
ATTORNEYS AT LAW
3100 FIRST NATIONAL BANK BUILDING
DALLAS, TEXAS 75202
(214) [illegible]
TELECOPIER
(214) [illegible]

IN DENVER, COLORADO
SHANK, IRWIN & HOLMES
[illegible] STREET SUITE [illegible]
DENVER, COLORADO [illegible]
(303) [illegible]
TELECOPIER
(303) [illegible]

IN WASHINGTON, D.C.
SHANK, IRWIN, CONANT,
WILLIAMSON & GREVELLE
[illegible]
(202) [illegible]

RECEIVED

Copy to Subc CCMA

CONGRESSMAN ROSENTHAL
RECEIVED
STAFF ________ DOC # ________
REC'D ________
APR 14 1980
FOR ________
COMMENTS ________
FILE CODE ________

April 11,1980

Honorable Benjamin S. Rosenthal
United States House of Representatives
Washington, D.C. 20515

Dear Congressman Rosenthal:

This firm represents Mr. Nelson Bunker Hunt and Mr. William Herbert Hunt.

This letter is in response to a telegram from you addressed to our clients, dated April 7, 1980, requesting their appearance before the Commerce, Consumer and Monetary Affairs Subcommittee of the United States House Committee on Government Operations (the "Subcommittee") to testify on a variety of topics delineated in that telegram.

Since the receipt of the telegram by our clients, I have had several conversations with counsel for the Subcommittee, Ms. Barbara Timmer. I have explained to Ms. Timmer that our clients wish to cooperate with the Subcommittee. On the other hand, I am sure you can recognize that the scope of the matters upon which the Subcommittee desires to inquire is extensive and complex. As I have previously explained to Ms. Timmer, it is virtually impossible for our clients to evaluate your request and to prepare properly for any such appearance on the limited notice afforded by the telegram.

Ms. Timmer has requested a date certain upon which our clients would be available to appear before the Subcommittee. I have been unable to talk with either of them concerning such a commitment. I have, therefore, advised Ms. Timmer that I shall contact her early next week to discuss a potential date for such appearance.

We would respectfully request that this letter be made a part of the permanent record of your Subcommittee.

Respectfully,

Robert B. Cousins, Jr.

Robert B. Cousins, Jr.

RBC/RG:ch

cc: Honorable Benjamin S. Rosenthal,
Chairman
Commerce, Consumer and Monetary Affairs
Subcommittee
Room B 377 Rayburn House Office Building
Washington, D.C. 20515

cc: Ms. Barbara Timmer
Counsel
Room B 377 Rayburn House Office Building
Washington, D.C. 20515

Mr. ROSENTHAL. Have we heard from them any further?

I am informed that we have not.

Since that letter, there has been no further communication from either the subcommittee——

Ms. TIMMER. I received a telephone call at the subcommittee office last Friday with a suggestion from the Hunts' attorney that this subcommittee, to use his words "cooperate with the Senate Agricultural Subcommittee" that they just agreed to testify in front of.

I suggested to him that it was a common procedure in the Congress for the House and Senate to be studying the same issues and that indeed we would cooperate with all those subcommittees when it came time for ultimate recommendations.

Mr. ROSENTHAL. Are there any questions?

We need one more to vote for a quorum.

Mr. MATSUI. Did he define what he meant by cooperate?

Ms. TIMMER. No, but he prefaced the comment by saying that they decided they would prefer to testify in front of another subcommittee.

Mr. MATSUI. Rather than ours?

Ms. TIMMER. Yes.

Mr. MATSUI. Did he give a reason?

Ms. TIMMER. No reason.

Mr. MATSUI. Do you know the date the other committee meeting will be held?

Ms. TIMMER. It was announced last Friday it would be held May 2.

Mr. MATSUI. In other words, the comments made in the letter from the attorney, which the Chairman just read, that they need time to prepare probably is no longer important; is that right?

Ms. TIMMER. Yes, I think that is right.

Mr. ROSENTHAL. The indications are that Mr. Conyers and Mr. Levitas are on their way.

We will take a brief recess.

[Recess taken.]

Mr. ROSENTHAL. The subcommittee will resume its sitting.

Are there are further questions on the subpenas?

We have copies of the subpenas for Nelson Bunker Hunt and William Herbert Hunt for an appearance before this subcommittee.

There are two separate subpenas. One is to William Herbert Hunt to appear before this subcommittee on April 29, 1980, room 2154, Rayburn House Office Building, at 10 a.m.

I will read this just for the record.

The matters under consideration are "in connection with the subcommittee's investigation of the operation of the silver markets, the adequacy of CFTC regulation of those markets, and the impact of recent fluctuations in those markets, on the securities and other financial markets regulated by the SEC, the Federal Reserve, the U.S. Treasury Department and the Federal bank regulatory agencies."

The other subpena is identical in substance and is to Mr. Nelson Bunker Hunt for appearance before this subcommittee on April 29, 1980, room 2154.

As indicated, both subpenas direct the United States Marshall in Dallas, Texas, to serve the subpenas.

Without objection, copies of both these subpenas will be inserted in the record.

[Subpenas referred to follow:]

ORIGINAL

BY AUTHORITY OF THE HOUSE OF REPRESENTATIVES OF THE CONGRESS OF THE UNITED STATES OF AMERICA

To United States Marshall

You are hereby commanded to summon William Herbert Hunt

of Dallas, Texas

to be and appear before the Subcommittee on Commerce, Consumer and Monetary Affairs of the Government Operations

Committee of the House of Representatives of the United States, of which the Hon. Benjamin S. Rosenthal is chairman, in connection with the subcommittee's investigation of the operation of the silver markets, the adequacy of CFTC regulation of those markets, and the impact of recent fluctuations in those markets, on the securities and other financial markets regulated by the SEC, the Federal Reserve, the U.S. Treasury Department and the Federal bank regulatory agencies.

in their chamber in the city of Washington, on April 29, 1980, in Room 2154 of the Rayburn House Office Building, at the hour of 10 a.m.

then and there to testify touching matters of inquiry committed to said Committee; and he is not to depart without leave of said Committee.

Herein fail not, and make return of this summons.

Witness my hand and the seal of the House of Representatives
of the United States, at the city of Washington, this
______ day of ____________, 19__

____
Jack Brooks
Chairman.

Attest:

____
Clerk.

ORIGINAL

BY AUTHORITY OF THE HOUSE OF REPRESENTATIVES OF THE CONGRESS OF THE UNITED STATES OF AMERICA

To United States Marshall

You are hereby commanded to summon Nelson Bunker Hunt of Dallas, Texas

to be and appear before the Subcommittee on Commerce, Consumer and Monetary Affairs of the Government Operations Committee of the House of Representatives of the United States, of which the Hon. Benjamin S. Rosenthal is chairman, in connection with the subcommittee's investigation of the operation of the silver markets, the adequacy of CFTC regulation of those markets, and the impact of recent fluctuations in those markets, on the securities and other financial markets regulated by the SEC, the Federal Reserve, the U.S. Treasury Department and the Federal bank regulatory agencies.

in their chamber in the city of Washington, on April 29, 1980, in Room 2154 of the Rayburn House Office Building, at the hour of 10 a.m.

then and there to testify touching matters of inquiry committed to said Committee; and he is not to depart without leave of said Committee.

Herein fail not, and make return of this summons.

Witness my hand and the seal of the House of Representatives of the United States, at the city of Washington, this

______ day of ______________, 19__

Jack Brooks
Chairman.

Attest:

Clerk.

Mr. ROSENTHAL. Before Mr. Levitas came in, we had advised the subcommittee of the number of matters that had taken place recently. A copy is included in the record of the telegram that was sent to them indicating the matters under consideration.

Mr. Matsui?

Mr. MATSUI. Mr. Chairman, I move that the subpenas which the Chairman just referred to, be issued in accordance with the drafts presented to each of the members with the proviso that Chairman Brooks of the full committee, after consultation with Chairman Rosenthal of the subcommittee, be authorized to change the return date if service does not occur prior to April 29, 1980.

Mr. ROSENTHAL. The clerk will call the roll.

The CLERK. Mr. Rosenthal?

Mr. ROSENTHAL. Aye.

The CLERK. Mr. Matsui?

Mr. MATSUI. Aye.

The CLERK. Mr. Atkinson?

Mr. ROSENTHAL. Aye, by proxy.

The CLERK. Mr. St Germain?

[No response.]

The CLERK. Mr. Conyers?

Mr. ROSENTHAL. Aye, by proxy.

The CLERK. Mr. Levitas?

Mr. LEVITAS. Aye.

The CLERK. Mr. Williams?

Mr. WILLIAMS. Aye.

The CLERK. Mr. Deckard?

Mr. DECKARD. Aye.

The CLERK. A quorum is present, Mr. Chairman.

There were five ayes, with two ayes by proxy, for a total of seven ayes.

Mr. ROSENTHAL. Thank you.

The third subpena is directed to the Commodity Futures Trading Commission for the production of the documents described below:

The complete tape—or if tapes were not made, the complete transcript, minutes, notes or memorandum—of CFTC meetings between August 1, 1979, and April 22, 1980—at which there was any discussion of silver trading; and the complete record of the Chicago Mercantile Exchange live cattle futures disciplinary proceedings against Ray E. Friedman and Company, requested by the subcommittee on March 8, 1980—one subpena.

Without objection, a copy of the subpena and relevant documents shall be inserted in the record at this point.

[Subpena to CFTC follows:]

Subpena Duces Tecum

By Authority of the House of Representatives of the Congress of the United States of America

To Hon. James Stone, Chairman, Commodity Futures Trading Commission

You are hereby commanded to produce the things identified on the attached schedule before the

SubCommittee on Commerce, Consumer, and Monetary Affairs

of the House of Representatives of the United States, of which the Hon. Benjamin S. Rosenthal is chairman, by producing such things in Room 2154 of the Rayburn House Office Building ______, in the city of Washington, on April 29, 1980, at the hour of 9:30 a.m.

To Barbara Timmer, Subcommittee Counsel, you are commanded to serve and make return.

Witness my hand and the seal of the House of Representatives of the United States, at the city of Washington, this ______ day of ______, 19__.

Jack Brooks *Chairman.*

Attest:

Edmund L. Henshaw, Jr. *Clerk.*

SCHEDULE OF DOCUMENTS SUBPOENAED

1. The complete tape (or if tapes were not made, the complete transcript, minutes, notes or memorandum) of CFTC meetings between August 1, 1979, and April 22, 1980, in which there was any discussion of silver trading.

2. The complete record, including all documents and material received from the Chicago Mercantile Exchange (CME), of the disciplinary proceeding involving Ray E. Friedman & Co., previously requested by the subcommittee March 8, 1980.

Mr. Rosenthal. I turn now to silver.

The subcommittee hearings on the silver futures market will be incomplete without a record of the CFTC decisionmaking process since the prices began to rise last summer.

We have heard, on tapes already under subpena, discussion of February and March 1980 silver futures as early as July of 1979.

At our hearings since the market collapse we have heard that the CFTC took no action to prevent the price squeeze and collapse and even allowed conflicting exchange actions which increased market turbulence.

Before we can make real and effective recommendations about the future of the CFTC and its relationship to other market regulatory agencies, we must understand and analyze their decisionmaking process, powers, and limitations.

The transcripts or tapes of these meetings are essential for our investigation.

Without objection, I will place in the record at this point correspondence between our committee and the CFTC.

[Correspondence referred to follows:]

March 8, 1980

Hon. James M. Stone, Chairman
Commodity Futures Trading Commission
2033 L Street, N.W.
Washington, D. C. 20581

Dear Mr. Chairman:

As part of our continuing investigation and oversight of the Commodity Futures Trading Commission, the Commerce, Consumer and Monetary Affairs Subcommittee (House Government Operations Committee) requests copies of the following documents by March 21, 1980:

1. The Chicago Mercantile Exchange report to the Commission dated February 11, 1980 (22 pages), cover letter and attached or supporting documents.
2. The record of the CME disciplinary proceeding, including a statement of the evidence, a description of particular rule violations and the testimony and documents adduced to support the CME action against Ray E. Friedman & Co. which resulted in a $250,000 fine, December 1979.

If there are any questions or if we can be of any assistance, please contact Barbara Timmer, counsel to the subcommittee. Thank you for your time and cooperation.

Sincerely,

Benjamin S. Rosenthal
Chairman

BSR:btv

Mr. ROSENTHAL. I turn now to cattle.

On March 21, 1980, the Commission voted 2 to 1, Chairman Stone voting present and Commissioner Gartner dissenting, to provide the subcommittee material requested on live cattle futures with certain key material deleted.

This information was requested as part of our continuing investigation of the August live cattle futures contract traded on the Chicago Mercantile Exchange.

The CME published a report finding no "manipulation" and then, in a separate action, fined REFCO—Ray E. Friedman and Company—one of the participants alleged to have been involved in the manipulation, the largest fine ever in Exchange history.

We have heard from other sources this fine may indeed include the practices outlined in our August 17, 1979, request for CFTC invesigation. The complete REFCO material is essential to our investigation.

Supporting documents for your information include:

One, letter from Jack Brooks, Chairman, House Government Operations, to James M. Stone, Chairman, CFTC, dated January 8, 1980, describing the jurisdiction of the Commerce, Consumer, and Monetary Affairs Subcommittee over the CFTC, and,

Two, section 8 of the Commodity Exchange Act which requires the CFTC to furnish information to Congress upon appropriate request.

The subcommittee will attach to the transcript of this meeting two documents from the American Law Division, Library of Congress, which detail the broad rights, authority, and power which this subcommittee has in the furtherance of its legitimate legislative and investigative functions.

These include:

"Congressional Access to Information from the Commodity Futures Trading Commission," November 29, 1979, and,

"*Gartner* v. *Rosenthal:* A Case Study in Congressional Access to Information," February 4, 1980.

Without objection, this material will be placed in the record at this point.

[The documents referred to follow:]

Committee Subpoenas
CC&MA Corres.
STONE, Hon. James M.

January 3, 1980

The Honorable James M. Stone, Chairman
Commodity Futures Trading Commission
2033 K Street, N. W.
Washington, D. C. 20581

Dear Mr. Chairman:

Your staff has requested verification of the jurisdiction of the Subcommittee on Commerce, Consumer, and Monetary Affairs of the House Committee on Government Operations in order to prepare the Commodity Futures Trading Commission's response to a subpoena authorized by the Subcommittee on December 19, 1979, signed by me on December 20, and served on you on December 21.

House Rule X, Clause 1(1) establishes the jurisdiction of the Committee on Government Operations. Subsection (2) of that Section provides that the Committee on Government Operations has jurisdiction over "the overall economy and efficiency of government operations and activities, including Federal procurement." This provision gives the Committee on Government Operations oversight jurisdiction over all Executive Branch departments and agencies and independent regulatory agencies. In addition, Clause 2 of Rule X reads as follows:

> "The Committee on Government Operations shall review and study, on a continuing basis, the operation of government activities at all levels with a view to determining their economy and efficiency."

Our committee rules, adopted on February 1, 1979, at our first meeting during the 96th Congress, provide that "There shall be seven subcommittees with appropriate party ratios which shall have fixed jurisdictions." At that same meeting, the committee approved a motion by the Honorable L. H. Fountain setting forth the titles, membership, and jurisdictions of the seven subcomittees. This action is duly recorded in both the transcript and the minutes of the February 1 meeting. Attachment A of the minutes lists the Commodity Futures Trading Commission under the jurisdiction of the Commerce, Consumer, and Monetary Affairs Subcommittee.

I hope that in the future the Commodity Futures Trading Commission will be more cooperative with the Committee on Governments Operations and its subcommittees in providing information needed to enable us to carry out our oversight responsibilities.

With best wishes, I am

Sincerely,

Jack Brooks
Chairman

INFORMATION TO CONGRESS: COMMODITY EXCHANGE ACT
SECTION 8

SEC. 16. Section 8 of the Commodity Exchange Act (7 U.S.C. 12, 12-1, 12-2, and 12-3) is amended to read as follows:

"SEC. 8. (a) For the efficient execution of the provisions of this Act, and in order to provide information for the use of Congress, the Commission may make such investigations as it deems necessary to ascertain the facts regarding the operations of boards of trade and other persons subject to the provisions of this Act. The Commission may publish from time to time the results of any such investigation and such general statistical information gathered therefrom as it deems of interest to the public: *Provided*, That except as otherwise specifically authorized in this Act, the Commission may not publish data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers.

One purpose of the Act is to provide information to Congress

"(b) The Commission may disclose publicly any data or information that would separately disclose the market positions, business transactions, trade secrets, or names of customers of any person when such disclosure is made in connection with a congressional proceeding, or in an administrative or judicial proceeding brought under this Act.

"(c) The Commission may make or issue such reports as it deems necessary, or such opinions or orders as may be required under other provisions of law, relative to the conduct of any board of trade or to the transactions of any person found guilty of violating the provisions of this Act or the rules, regulations, or orders of the Commission thereunder in proceedings brought under section 6 of this Act. In any such report or opinion, the Commission may set forth the facts as to any actual transaction or any information referred to in subsection (b) of this section, if such facts or information have previously been disclosed publicly in connection with a congressional proceeding, or in an administrative or judicial proceeding brought under this Act.

"(d) The Commission, upon its own initiative or in cooperation with existing governmental agencies, shall investigate the marketing conditions of commodities and commodity products and byproducts, including supply and demand for these commodities, cost to the consumer, and handling and transportation charges. It shall also compile and furnish to producers, consumers, and distributors, by means of regular or special reports, or by such other methods as it deems most effective, information respecting the commodity markets, together with information on supply, demand, prices, and other conditions in this and other countries that affect the markets.

"(e) The Commission may disclose and make public, where such information has previously been disclosed publicly in accordance with the provisions of this section, the names and addresses of all traders on the boards of trade on the commodity markets with respect to whom the Commission has information, and any other information in the possession of the Commission relating to the amount of commodities purchased or sold by each such trader. Upon the request of any committee of either House of Congress, acting within the scope of its jurisdiction, the Commission shall furnish to such committee the names and addresses of all traders on such boards of trade with respect to whom the Commission has information, and any other information in the possession of the Commission relating to the amount of any commodity purchased or sold by each such trader. Upon the request of any department or agency of the Executive Branch of the Government of the United States, acting within the scope of its jurisdiction, the Commission may furnish to such department or agency any information in the possession of the Commission obtained in connection with the administration of this Act. However, any information furnished under this subsection to any Federal department or agency shall not be disclosed by such department or agency except in any action or proceeding under the laws of the United States to which it, the Commission, or the United States is a party.

"shall" provide to Congress ⇒

"(f) The Commission shall submit to Congress a written report within one hundred and twenty days after the end of each fiscal year detailing the operations of the Commission during such fiscal year. The Commission shall include in such report such information, data, and legislative recommendations as it deems advisable with respect to the administration of this Act and its powers and functions under this Act.

"(g) The Comptroller General of the United States shall conduct reviews and audits of the Commission and make reports thereon. For the purpose of conducting such reviews and audits, the Comptroller General shall be furnished such information regarding the powers, duties, organizations, transactions, operations, and activities of the Commission as the Comptroller General may require and the Comptroller General and the duly authorized representatives of the Comptroller General shall, for the purpose of securing such information, have access to and the right to examine any books, documents, papers, or records of the Commission, except that in reports the Comptroller General shall not include data and information that would separately disclose the business transactions of any person and trade secrets or names of customers, although such data shall be provided upon request by any committee of either House of Congress acting within the scope of its jurisdiction.".

"shall" provide to Congress ⇒

B. AMERICAN LAW DIVISION MEMORANDUM, "CONGRESSIONAL ACCESS TO INFORMATION FROM THE COMMODITY FUTURES TRADING COMMISSION," NOVEMBER 29, 1979, LIBRARY OF CONGRESS

THE LIBRARY OF CONGRESS

Congressional Research Service

WASHINGTON, D.C. 20540

November 29, 1979

TO : Commerce, Consumer and Monetary Affairs Subcommittee
Attn: Barbara Timmer

FROM : American Law Division

SUBJECT: Congressional Access to Information from the Commodity Futures Trading Commission

The Commodity Futures Trading Commission (CFTC) (7 U.S.C. 1 et seq.) has declined to furnish certain information requested by the Commerce, Consumer, and Monetary Affairs Subcommittee of the House Government Operations Committee. This memorandum will briefly discuss some issues which have been preliminarily raised. As of this writing, the Commission has not formally refused the request.

An initial question is whether the provision in 7 U.S.C. 12(e), 7 USCS 12(e) (1979 Supp.), directing that "[u]pon the request of any committee of either House of Congress, acting within the sphere of its jurisdiction, the Commission shall furnish to such committee the names and addresses of all traders on such boards of trade with respect to whom the Commission has information, and any other information in the possession of the Commission relating to the amount of any commodity purchased or sold by each such trader," precludes release of information to a subcommittee[1] of Congress. We have found nothing in the legislative history of the Act or elsewhere which indicates that such a restrictive interpretation was intended.

The precursor of the CFTC Act, the Grain Futures Act of 1922,[2] vested primary regulatory authority in the Secretary of Agriculture. Section 8 of that Act authorized secretarial investigations of boards of trade and publication of certain investigative results "... [f]or the efficient execution of the provisions of this Act, and in order to provide information for the use of Congress..."[3] This rationale for the investigatory and disclosure duties of the Secretary (and, since 1974, the CFTC), namely, informing Congress, has been retained in the Act[4] and would seem to argue against an interpretation that would unduly restrict this congressional informational access purpose.

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[1] The specific information sought from the CFTC is detailed in a November 15, 1979 letter to CFTC Chairman Stone from subcommittee Chairman Rosenthal. No argument has been made that the information sought does not come within the description of that information which must be provided upon congressional request pursuant to 7 U.S.C. 12(a), i.e., "... other information in the possession of the Commission relating to the amount of any commodity purchased or sold by each such trader."

[2] 42 Stat. 998 (1922).

[3] 42 Stat. 1003.

[4] See, 7 U.S.C. 12 (1976); 7 USCS 12(a) (1979 Supp.).

The specific provision directing[5] secretarial disclosure upon request of congressional committees was added in 1947.[6] This amendment was precipitated by a dispute between the Secretary of Agriculture and the Senate Appropriations Committee. The Committee, in the course of investigating allegedly irregular activities of the commodity exchanges, had asked for a list of traders and their transactions on the commodity markets. The Secretary felt constrained by the law's prohibitions[7] and was advised by his solicitor that congressional access was embraced within the prohibition.[8] After much debate,[9] a joint resolution was ultimately enacted providing for disclosure to "any committee of either House of Congress, acting within the scope of its jurisdiction."

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[5] The language of the congressional committee access provision is mandatory, unlike the immediately preceding provision for discretionary release of the same information to the public. This public release authority is discretionary even though such release is not triggered unless the information "has previously been disclosed publicly in accordance with the provisions of this section." 7 USCS 12 (e) (1979 Supp.). See also, 7 USCS 12(b) (1979 Supp.). The mandatory feature of the congressional access provision illustrates the importance attached to this responsibility of the CFTC.

[6] 61 Stat. 941 (1947).

[7] Section 8 of the 1922 Act permitted release of the results of secretarial investigations, "except data and information which would separately disclose the business transactions of any person and trade secrets or names of customers..." 42 Stat. 1003. That prohibition remains in the law but is prefaced by the proviso, "except as otherwise specifically authorized in this Act..." 7 USCS 12(a).

[8] See, 93 Cong. Rec. 11617 (1947).

[9] See, 93 Cong. Rec. 11494-5, 11612-11621, 11641, 11740 (1947).

The right of Congress (and the public)[10] to obtain this information was vigorously argued during the debate. Many also argued that amending the law was not necessary; that Congress had the right presently to subpena information it desired. They warned that passing a law created a bad precedent by making congressional access rights subject, in effect, to presidential approval (in the form of the President's veto power over bills passed by the Congress).[11]

We have found no indication in the legislative history of the 1947 congressional access provision that the use of the phrase "any committee" was intended to be restrictive or preclude subcommittee access. The purpose of the provision was to insure and enhance congressional access. Arguments were made that such an access provision was not necessary because Congress already had the authority (meaning, presumably, Congress, acting through its committees and subcommittees) to subpena the information. No limitations on this inherent authority were voiced and the enactment of the explicit access authority did not purport to be anything other than a specific recognition of existing congressional rights (which, the Secretary argued, had been statutorily limited by the 1922 prohibition).

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[10] The 1947 provision required the Secretary to make the information he supplied to the Congress public. 42 Stat. 1003; 7 U.S.C. 12-1 (1976). This requirement of simultaneous public release was repealed in 1978 to allay the commission's fears of public disclosure of sensitive information requested by Congress. See, 7 USCS 12(e) (1979 Supp.); H. Rept. 95-1181, 95th Cong., 2d Sess. (1978).

[11] 93 Cong. Rec. 11495, 11647, 11742.

At the same time the access provision was being debated and passed, a select committee was established in the House to investigate the commodity markets.[12] Subcommittees of that select committee were authorized to be formed and subpena witnesses and records. Some also argued that a subcommittee of the Agricultrue Committee, rather than a select committee, could and should conduct the investigation.[13] This contemporaneous discussion of subcommittee power and authority, combined with the argument that the section 8 access provision merely reflected existing congressional powers, would seem to militate against placing a restrictive cast upon the use of the words "any committee" in the access provision. Subcommittees were a tool of congressional investigation. There is no indication that Congress intended to limit use of that tool when it enacted the access provision. To the contrary, it intended to speed and facilitate congressional access to information it deemed entitled to.[14]

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[12] See, 93 Cong. Rec. 11640. See generally, H. Rept. Nos. 2025, 2449, 2462, 2472, 80th Cong., 2d Sess. (1948) (reports of the House Select Committee to Investigate Commodity Transactions).

[13] 93 Cong. Rec. 11643, 11647.

[14] The provision was carried over in 1974 when the CFTC was created and in the 1978 reauthorization (with the exception of the repeal of the simultaneous public release requirement). A perusal of the legislative history of those enactments revealed no indication of a restrictive interpretation precluding subcommittee access to information under section 8 of the Act. See, H. Rept. 93-975, 93-1383, S. Rept. 93-1131, 93d Cong., 2d Sess. (1974); Hearings Before the Senate Committee on Agriculture and

(Continued)

Subcommittees have proliferated and are employed more frequently in oversight and investigation than was probably the case in 1947. Standing committees of over twenty members are, in fact, required, under the House Rules, to either "establish an oversight subcommittee, or require its subcommittees, if any, to conduct oversight in the area of their respective jurisdiction ..."[15] Subcommittees as well as committees are authorized to hold hearings and subpena witnesses and records.[16] In many ways, subcommittees are the alter egos of committees in conducting oversight and investigations.[17] Given the essential role of subcommittees

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(14 Continued) Forestry, Pts. 1-3, 93d Cong., 2d Sess. (1974); Hearings Before the House Agriculture Comm., 93d Cong., 2d Sess. (1974); 120 Cong. Rec. 10736-10769, 30458-30468, 34736-34754, 34995-35003 (1974). With respect to the 1978 reauthorization, see, H. Rept. 95-1181, 95-1628, S. Rept. 95-850, 95th Cong., 2d Sess. (1978); Hearing on Reauthorization of the Commodity Futures Trading Commission before the Subcomm. on Agricultural Research and General Legislation of the Senate Comm. on Agriculture, Nutrition and Forestry, Pts 1, 2, 95th Cong., 2d Sess. (1978).

[15] House Rule X, cl. 2(b)(1). The Commerce, Consumer, and Monetary Affairs Subcommittee of the Government Operations Committee was given explict jurisdiction over the CFTC in the 96th Congress. The full committee has broad oversight jurisdiction over all federal agencies. See, House Rule X, cl. 1(i); X, cl. 4(c); 5 U.S.C. 2954. No question has yet been raised regarding the subject matter jurisdictional basis of the subcommittee's request. Should subpena of the information or court enforcement prove necessary delegations of authority and jurisdictional parameters may be important. See, Ashland Oil, Inc. v. FTC, 409 F. Supp. 297 (D.D.C.) aff'd, 548 F. 2d 977 (CADC 1976); Gojack v. United States, 384 U.S. 702 (1966).

[16] House Rule XI, cl. 2(m).

[17] See, House Rule XI, cl. 1(a)(2).

in the legislative process and their independent authority, it would seem inconsistent with the overall purpose of the section 8 access provisions to deny them access on the basis of an interpretation of the language which is arguably not compelled by the text nor inferable from the legislative history.

The CFTC has also apparently pointed to its own regulations in defending its refusal to divulge information to the subcommittee. 17 CFR 11.3 (1978) provides that all information obtained during an investigation shall be treated as "nonpublic" except to the extent the Commission authorizes disclosure, the information has become a matter of public record, or, disclosure is required by the Freedom of Information Act. Of course, an agency regulation can not override a statutory direction, the source of the authority to issue the regulation being a statutorily delegated authority. To the extent the information sought comes within the scope of 7 U.S.C. 12(e), an agency regulation inconsistent with the statutory mandate, can not be effective.[18] Finally, congressional access can not be equated with "public" access; disclosing information to Congress does not automatically destroy its "nonpublic" nature. 19/

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[18] As noted above, the CFTC has not argued that the information requested does not come within the terms of 7 U.S.C. 12(e). If that were the case, however, congressional access would not thereby necessarily be precluded. Congress has broad, constitutinally - based powers to obtain information from the executive and is not dependent on statutory authority for its information - gathering powers. See e.g., *Eastland* v. *United States Servicemen's Fund*, 421 U.S. 491 (1975); *Watkins* v. *United States*, 354 U.S. 178 (1957); *McGrain* v. *Daugherty*, 273 U.S. 135 (1957); *United States* v. *AT&T*, 551 F. 2d 384 (CADC 1976); 567 F. 2d 121 (CADC 1977) (second opinion).

The foregoing has been a preliminary discussion of issues which have been raised regarding the subcommittee's request for information from the CFTC. The agency's position has apparently yet to be formalized and this memorandum makes no attempt to anticipate arguments which might be raised. The Commission has not relied on other statutory authority to refuse access and we are not aware of such a self-imposed statutory restriction on congressional access with respect to this type of information. Executive privilege has also not been asserted. If further analysis of these or other questions is desired as the dispute progresses, feel free to contact us.

Richard Ehlke
Legislative Attorney

19/ See, Ashland Oil, Inc. v. FTC., 409 F. Supp. 297 (DDC), aff'd, 548 F.2d 977 (CADC 1976). See also, Exxon Corp. v. FTC, 589 F.2d 582 (CADC 1978), cert. denied, 47 USLW 3747 (1979).

C. AMERICAN LAW DIVISION MEMORANDUM, "*GARTNER* v. *ROSENTHAL*: A CASE STUDY IN CONGRESSIONAL ACCESS TO INFORMATION," FEBRUARY 4, 1980, LIBRARY OF CONGRESS

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

February 4, 1980

TO : House Subcommittee/Commerce, Consumer, Monetary Affairs
Attn: Peter Barash

FROM : American Law Division

SUBJECT : Gartner v. Rosenthal: A Case Study in Congressional Access to Information

Enclosed please find the above entitled report. As you requested, we have analyzed the background and impact of the case as well as the role of the Department of Justice in the proceedings.

Richard Ehlke
Richard Ehlke
Legislative Attorney

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

GARTNER v. ROSENTHAL: A CASE STUDY IN CONGRESSIONAL ACCESS TO INFORMATION

Richard C. Ehlke
Legislative Attorney
American Law Division
February 4, 1980

GARTNER v. ROSENTHAL
A CASE STUDY IN CONGRESSIONAL ACCESS TO INFORMATION

Gartner v. Rosenthal, Civ. No. 80-0169 (D.D.C. January 23, 1980), stay pending appeal denied, No. 80-1105 (CADC, January 22, 1980), arising out of a House subcommittee's efforts to obtain information from the Commodity Futures Trading Commission, provides an interesting case study in the rights of Congress to access to information, the role of the Department of Justice in representing the interests of Congress in access disputes, and the role of the courts in litigation resulting from congressional demands for information.

I.

In response to complaints of alleged price manipulation in the cattle futures market in July and August, 1979, Representative Benjamin Rosenthal, as Chairman of the Subcommittee on Commerce, Consumer, and Monetary Affairs of the House Government Operations Committee, requested the Commodity Futures Trading Commission (CFTC) to investigate the charges of price fixing and collusion. A follow-up letter to the Commission requested access to certain data deemed necessary to the subcommittee's oversight of the Commission's handling of this particular incident as well as the agency's operations in preventing manipulation in the futures market. Material sought included copies of minutes, notes, or memoranda from or pertaining to CFTC surveillance meetings for the relevant period, preliminary staff reports and weekly surveillance reports and memoranda, correspondence between the CFTC and the Chicago Mercantile Exchange regarding cattle futures trading, and other documents relating to the futures market and CFTC investigation.

The Commission, in letters to Chairman Rosenthal of November 30 and December 18, 1979, described its operations in investigating the alleged price manipulation in the cattle futures market, provided access to some of the material requested, but declined to disclose to the subcommittee certain information which it claimed it was prohibited from divulging by statute. The Commission pointed to section 8(a) of the Commodity Exchange Act (as amended by the Futures Trading Act of 1978), which provides that "except as otherwise specifically authorized in this chapter, the Commission may not publish data and information that would separately disclose the business transactions or market position of any person and trade secrets or names of customers." [1] It acknowledged that section 8(e) of the Act contains an exception to the above prohibition in mandating that "[u]pon the request of any committee of either House of Congress, acting within the scope of its jurisdiction, the Commission shall furnish to such committee the names and addresses of all traders on such boards of trade with respect to whom the Commission has information, and any other information in the possession of the Commission relating to the amount of any commodity purchased or sold by each trader." [2] However, the Commission interpreted that provision as applying only to requests or subpoenas from committees and not to requests from subcommittees. [3] The Commission, therefore, determined not to "provide this category of information to you unless it receives a lawfully issued subpoena from your subcommittee or a formal written request from the full House Committee on Government Operations."[4]

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[1] 7 U.S.C.A. 12(a) (1979 Supp.)

[2] 7 U.S.C.A. 12(e) (1979 Supp.)

[3] See, Letter of December 18, 1979 from the Commission to Chairman Rosenthal at 3. 7 U.S.C.A. 12(b) permits the Commission to disclose section 8(a) information "in connection with a congressional proceeding." Distinguishing what it viewed as this discretionary authority from the mandatory committee access provision, the Commission declined to exercise its discretion and release requested information encompassed within Section 8(a) to the Subcommittee. Id. at 5.

The Commission's position, it was argued, depended on an overly literal reading of the law and ignored the overall purpose of the provisions governing access to information from the Commission.[5] One purpose of the investigative and fact-gathering authority of the CFTC is to "provide information for the use of Congress...,"[6] and Congress, by inserting sunset provisions in the Act, has indicated its desire, through periodic reauthorization hearings, to oversee closely the operations of the Commission.[7] Given the clearly stated intent that Congress be fully informed of the operations of the CFTC and the primary role subcommittees play in fulfilling the oversight and investigative role of

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4/ *Id.* at 1. The Commission also refused to comply with a request from a Senate subcommittee for similar information on the same grounds. Letter of November 27, 1979 to Chairman Max Baucus, Subcommittee on Limitations of Contracted and Delegated Authority, Senate Judiciary Committee. In both instances, the vote of the Commission not to disclose certain information was 3-1, Chairman Stone dissenting.

5/ The counterarguments to the CFTC interpretation of the confidentiality provision are contained in a November 29, 1979 memorandum to the subcommittee from the American Law Division, Congressional Research Service. For a general discussion of confidentiality statutes and their impact on congressional access to information, see, Congressional Research Service, Congressional Access to Information: Selected Problems and Issues, Report No. 79-220A (October 16, 1979).

6/ 7 U.S.C.A. 12(a) (1979 Supp.).

7/ See, 7 U.S.C. 16(d) (1970); 7 U.S.C.A. 16(d) (1979 Supp.); Hearing on Reauthorization of the Commodity Futures Trading Commission Before the Subcommittee on Agricultural Research and General Legislation of the Senate Comm. on Agriculture, Nutrition and Forestry, Pts. 1, 2, 95th Cong., 2d Sess. (1978).

The Comptroller General, an arm of Congress, is also given broad auditing and information access authority over the CFTC. 7 U.S.C.A. 12(g) (1979 Supp.). See also, 7 U.S.C.A. 12(h) (transmittal of budget requests and legislative recommendations to congressional committees).

Congress,[8] a restrictive interpretation of a provision intended to facilitate congressional access to information would not seem warranted.

Despite misgivings over issuing a subpoena in the face of a statutory obligation to provide the requested information, the subcommittee voted a subpoena on December 19, 1979. The subpoena embraced those materials sought in earlier requests but withheld by the Commission as well as copies of tapes of the weekly surveillance meetings for the relevant period. The Commission voted 3-1 to comply with the subpoena by the return date of January 23, 1980, Commissioner Gartner objecting to the release of tapes of the secret Commission surveillance meetings[9] in which he participated.

Commissioner Gartner filed suit against his fellow commissioners and the subcommittee members and staff director seeking to prevent enforcement of and compliance with the subpoena.[10] A hearing was held January 22, 1980, the day before the subpoena return date, on Gartner's motion for a temporary restraining order.[11] The United States Attorney's Office represented the CFTC commissioners

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8/ See, House Rule X, describing the role of subcommittees and the jurisdiction of committees, including the broad oversight jurisdiction of the Government Operations Committee. The Commerce, Consumer, and Monetary Affairs Subcommittee was given explicit jurisdiction over the CFTC by the full committee. Subcommittees are authorized to hold hearings and subpoena witnesses and records (House Rules XI, cl. 2(m)) and in many ways are the alter egos of committees in conducting oversight and investigation. See, House Rule XI, cl. 1(a)(2).

9/ The meetings had been closed pursuant to the Government in the Sunshine Act. 5 U.S.C. 552b (1976).

10/ A similar suit was also filed with respect to a subpoena issued by the Senate subcommittee. See, note 4, supra.

11/ Temporary injunctive relief was not sought in the Senate action as the date of return of the subcommittee's subpoena was extended to February.

and also appeared on behalf of the subcommittee defendants. The primary argument in opposition to Gartner's claim was that, as a single member of a Commission, outvoted by the majority, he had no standing to assert a privilege with respect to materials which the majority voted to disclose to the subcommittee. The standards for granting temporary injunctive relief were not present – Gartner had not shown a substantial likelihood of success on the merits of his claim of personal privilege; the harm, if any, in release of the tapes of conversations was speculative; and, the public interest outweighed any harm which might occur upon denying injunctive relief.

District Judge Richey denied the motion for a temporary restraining order in a ruling from the bench shortly after the hearing. He also denied a stay pending appeal. Gartner sought a stay from the United States Court of Appeals that afternoon, but the motion was denied.[12/] Thereafter, he voluntarily dismissed the appeal and dropped the suit against the Senate subcommittee.

II.

The court's order in Gartner v. Rosenthal represents a significant affirmation of Congress' right to information necessary for its oversight and investigative functions. Tracking the four tests for temporary injunctive relief,[13/] the court rejected Gartner's claims in an opinion recognizing the importance of congressional

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12/ Gartner v. Rosenthal, No. 80-1105 (CADC, January 22, 1980).

13/ See, Washington Metropolitan Area Transit Commission v. Holiday Tours, Inc., 559 F.2d 841 (CADC 1977); Virginia Petroleum Jobbers Association v. Federal Power Commission, 259 F.2d 921 (CADC 1958).

investigative functions and the limited role of the courts in interfering with such functions.

To obtain a temporary restraining order, a plaintiff must first demonstrate a likelihood of success on the merits of his underlying claim. The court found that the privilege asserted by Gartner - the executive privilege for confidential communications - belongs to the government and could not be asserted by an individual member of a collegial commission who had been outvoted by his fellow commissioners. The court held that such a claim does not give rise to even a possibility, much less a substantial likelihood, of success on the merits. Rejecting Gartner's standing to bring the suit, the court also stated, 14/ in denying a stay of its order pending appeal, that

> ...even if you had standing and even if you had a cognizable claim, ... it is the opinion of this court that this case represents an instance where the doctrine of judicial abstention would be most appropriate and should be applied because of the broad public interest that favors the Congress of the United States and its duly authorized committees to properly perform their legislative functions.

The court found that the harm to Gartner if temporary relief was denied was speculative at best and that his ability to function as a member of the Commission would not be impaired if relief was denied. Furthermore, any potential harm to

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14/ The court's order denying plaintiff's motion for a temporary restraining order incorporated the remarks made in open court. An extract of the court's findings is attached to the order and quotations and references in the text are taken from that extract. Gartner v. Rosenthal, Civ. No. 80-0169 (D.D.C. January 23, 1980). Excerpts from the order and extracts also are reprinted at 126 Cong. Rec. H 157 (January 23, 1980) (daily ed.).

plaintiff was outweighed by the harm to the majority of Commission members and to Congress. Permitting individual members to bring such suits was seen as "hamper[ing] all other independent regulatory agencies, which are collegial bodies, by permitting members of those agencies in the minority to overturn determinations by the majority." The court concluded with a description of the harm to Congress if plaintiff prevails and equated such harm to that which would be suffered by the public interest:

> If the coequal legislative branch, namely, the Congress, in this instance, that is to say, at least the House of Representatives, cannot obtain access, as it has repeatedly sought, and particularly cannot obtain access to the tapes in question, it would be substantially hindered in its oversight function.
>
> And, therefore, the public interest would be substantially harmed, when weighed against the speculative harm to the minority member of the commission in the case at bar.
>
> In sum, this court will not interfere with the power of Congress to fulfill its investigative and oversight functions as given to it by the constitution and the rules of the House of Representatives.

In denying the application for a stay pending appeal, the court reiterated that it "will not interfere, unless compelled to do so by the law which is not the case here, with a duly constituted member - and I use that word in quotes - of a tripartite branch of government, in this case the House of Representatives, and thus thwart its ability to perform its investigative, as well as oversight, functions." It held that the Congress should be allowed "to pursue its subpoena with all deliberate speed and without interference by the disappointed minority member of the commission."

Gartner v. Rosenthal is significant in several respects in terms of congressional access to information. The uniqueness of the suit by a minority member of a collegial independent regulatory commission presented a case of first impression. It drew the Justice Department to appear on behalf of both the majority commissioners as well as the subcommittee defendants. The case was also swiftly adjudicated with no delay in the return date of the subpoenas and a strong affirmation of congressional rights. This is in marked contrast to other recent cases involving congressional access to information.

Ashland Oil, Inc. v. FTC [15] was similar to Gartner in that Ashland Oil was attempting to prevent the Federal Trade Commission from complying with a request for company documents in the possession of the FTC by a House subcommittee. Unlike Gartner, however, a temporary restraining order against compliance with the congressional subpoena was granted. While permanent injunctive relief was ultimately denied, the case took over a year to resolve thereby delaying the subcommittee investigation for which the documents had been sought. [16]

Injunctive relief against a congressional subpoena was also obtained in United States v. A.T.& T. [17] There, the Justice Department sued A.T. & T. to prevent it from disclosing to a House subcommittee certain national security

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15/ 409 F.Supp 297 (D.D.C.), aff'd, 548 F.2d 977 (CADC 1976).

16/ See, Committee Print 95-19, The Ashland Litigation: A Case Study in Judicial Delay of a Congressional Investigation, Oversight and Investigations Subcommittee of House Comm. on Interstate and Foreign Commerce, 95th Cong., 1st Sess. (1977).

17/ 419 F.Supp. 454 (D.D.C. 1976), aff'd in part and remanded, 551 F.2d 384 (CADC 1976) (first opinion); 567 F.2d 121 (CADC 1977) (second opinion); dismissed by stipulation, Civ. No. 76-1372 (D.D.C., December 12, 1978).

wiretap information. Claims of executive privilege were involved in the case. While the Court of Appeals' opinions contain language supportive of congressional prerogatives, its successive remands of the case in an effort to arrive at a negotiated settlement and avoid a ruling on the merits of what it termed "nerve-center constitutional questions",[18] caused a more than two-year delay in the congressional investigation which spawned the case.[19]

The court in Gartner, on the other hand, was sensitive to the performance by Congress of its oversight and investigative functions and recognized the harm to such functions involved in granting temporary injunctive relief. The court's expeditious treatment of the case was likely the result of its view of the lack of merit in plaintiff's assertion of a right to bring such a suit. Nevertheless, the needs of Congress and its prerogatives as a co-equal branch of government greatly influenced its holding and contributed to a desire on the part of the court not to "thwart [Congress'] ability to perform its investigative, as well as oversight, functions."

III

The posture of the case - a minority member of a regulatory agency suing his fellow commissioners and a congressional subcommittee - made Gartner v. Rosenthal a unique case and one unlikely to be repeated, especially in light of the court's ruling. The role of the Department of Justice (principally, the United States Attorneys office) also was somewhat unique and is of interest both in light of past positions of the Department vis-a-vis litigation involving congressional access to information and for future cases.

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[18] 551 F.2d at 394.

[19] See generally, Congressional Research Service, Report No. 79-220A, supra note 5 at 13-19.

The Department appeared on behalf of both the CFTC commissioners and the subcommittee defendants. It submitted a memorandum on behalf of the commissioners which argued lack of standing and the failure to satisfy the standards for temporary injunctive relief. The opposition filed for the subcommittee by the United States Attorney consisted of documents establishing the subcommittee's jurisdiction. Because of disagreements with portions of the commissioners' memorandum, the government attorney was instructed to disclaim subcommittee concurrence in all that was stated in the memorandum.

The eventual outcome of the case rendered academic any potential conflicts between the Department and the subcommittee in the handling of the Gartner suit. The strength of the threshold argument that Gartner lacked standing resulted in a swift judicial affirmance of the subcommittee's right to the information. However, the standing argument was pursued by the Department exclusively in the context of the impact that upholding standing to bring such suits would have on the operations of executive and independent agencies. The Department's papers and arguments did not reflect the rights of Congress to information and the effects of litigation on congressional investigatory and oversight functions.

The Department presented no alternative arguments based on congressional prerogatives and the constitutionally - based rights of Congress to information. If standing had been found or a temporary restraining order had been granted, the position of the Department with respect to pursuing the subcommittee's rights was unclear. It is unlikely, however, that it would have advocated vigorously such matters as the relevance of the Speech or Debate Clause to Congress' right to information and the function of the courts in adjudicating information access disputes.

Article 1, Section 6 of the Constitution provides, in part, that "for any Speech or Debate in either House, [Senator and Representatives] shall not be questioned in any other place." In _Eastland_ v. _United States Servicemen's Fund_,[20] the Supreme Court held that congressmen and their aides are immune from being sued by parties seeking to enjoin the issuance and enforcement of a subpoena for documents issued in the course of a legitimate legislative investigation. It has been argued that this immunity is even broader and extends to limit the scope of judicial review of challenges to congressional requests or subpoenas of information in situations not involving members of Congress as named defendants.[21]

Both _Ashland_ and _A.T. & T._, recent congressional information access cases discussed above, were suits against third party custodians of records sought by congressional subcommittees. Congressmen entered the cases as intervenor-defendants and were not named by plaintiffs as defendants. The court in _Ashland_ did not discuss the Speech or Debate Clause. The _A.T. & T._ court did not rule on the matter but indicated that Speech or Debate immunity was limited to cases in which members of Congress were named as defendants.[22]

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[20] 421 U.S. 491 (1975).

[21] See, _United States_ v. _A.T. & T._, 419 F.Supp. 454, 458-9 (D.D.C. 1976). The Court in _Eastland_ did not exclusively focus on the presence of congressional defendants but emphasized the disruption to congressional inquiries caused by litigation seeking to enjoin compliance with a subpoena. 421 U.S. at 511. See, Lee, Executive Privilege, Congressional Subpoena Powers, and Some Relationships, 1978 Brig. Young L. Rev. 231, 242-8.

[22] See, 567 F.2d at 129, 130.

Gartner was a suit against both the third-party custodian of records (the CFTC) and named congressional defendants. Arguably, the Speech or Debate Clause could have been grounds to dismiss the suit at least against the congressional defendants and, if a broader reading of the Clause is accepted, to dismiss the case entirely.

The Department of Justice has argued in the past that the Speech or Debate Clause can only be asserted in actions against named congressional defendants.[23] It did not make such an argument in seeking dismissal of Gartner's suit against subcommittee members and staff and, in light of its past position, it could not have been expected to advocate a broader application of Speech or Debate immunity in case the standing argument was not successful or the temporary restraining order had been issued thereby delaying compliance with the subpoena.[24] As it happened, the standing argument was dispositive and the litigation was promptly resolved in *Gartner*. In other cases, however, where there may not be a concurrence of interests in a threshold argument such as standing, representation of congressional interests by the Department of Justice may pose significant potential conflicts.[25]

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[23] Brief for the United States in *United States* v. *A.T.T.*, cited at Lee, supra note 21 at 247.

[24] The subcommittee, after some initial reluctance on the part of the government attorneys, succeeded in having placed in the record documents outlining the jurisdiction of the committee, the bona fides of the subpoena, and the nature of the investigation. Arguably this would be all that would be necessary in gaining dismissal of a suit against congressional defendants seeking to prevent compliance with a subpoena. *Eastland*, 421 U.S. at 501, 511.

[25] The Department's position in *Ashland Oil* v. *FTC*., a case with a posture similar to that of *Gartner*, has been described as "ambiguous" and prompted one subcommittee to declare that it "could not conclude that the government's defense

25/ (continued)

IV

Gartner v. Rosenthal presents an unique case study in Congress' rights to information. A member of a regulatory agency suing his colleagues and the Department of Justice representing both an executive branch agency and a congressional subcommittee provided unusual twists to the traditional information access dispute. While the outcome is attributable in large part to the weakness of a standing argument which is not likely to be present in most congressional access cases, the court's ruling, swiftly arrived at, nevertheless contains strong language upholding Congress' constitutionally-based investigative and oversight functions.

Richard C. Ehlke
Legislative Attorney
American Law Division
February 4, 1980

25/ (continued) of the case would be as vigorous and as ardent as it itself could present, and as was necessary to protect its interests." Committee Print, supra note 16 at 9.

In A.T. & T., of course, it was the Department which brought suit to enjoin compliance with the subcommittee subpoena. The Department has, in other contexts, taken a restrictive view of congressional rights to access to information. See generally, Congressional Research Service, Report No. 79-220A, supra note 3.

Mr. **Rosenthal**. On the subpena for the CFTC, this is a continuing investigation of the CFTC on both the silver issue and on other related matters.

There is a schedule attached to the subpena.

Are there any questions on this at all?

Mr. Williams?

Mr. **Williams**. I move that the subpena be adopted, which is available to the members.

Mr. **Rosenthal**. Mr. Levitas?

Mr. **Levitas**. Mr. Chairman, this is the subpena to the CFTC. I intend to vote against this. I would like to state my reasons for doing so.

I stated this the last time we discussed a similar matter. It is my understanding the law requires the CFTC to provide us with this information. That is what the words say.

And, for a Federal agency to blatantly not follow the law is inexcusable. I do not think we need to subpena. I think there are other remedies that, if necessary, we can resort to.

Mr. **Rosenthal**. I am sympathetic. I thoroughly agree with you. They refuse to turn over the documents without a subpena. There are a number of remedies available from impeachment on down.

I would suggest myself that the subcommittee vote for the subpena and any other remedies that the gentleman from Georgia has available, I think we ought to pursue.

I agree with you.

Mr. **Levitas**. For the record, let me read what the law says. If this is not the law, then I hope I will be corrected.

It says: "Upon the request of any committee of either House of Congress, acting within the scope of its jurisdiction, the Commission shall furnish to such committee the names and addresses of all traders . . . ."

It is clear English. They are refusing to do it.

Mr. **Rosenthal**. Yes, they are refusing to do it.

Mr. **Levitas**. I would like to request a copy of this law be made a part of the record.

Mr. **Rosenthal**. Without objection, so ordered.

[Material referred to appears on p. 505.]

Mr. **Rosenthal**. I am open to suggestions.

Mr. **Levitas**. How about contempt?

Mr. **Rosenthal**. We cannot hold them in contempt without execution of a subpena. I am perfectly willing to take the most forthright action available.

Mr. **Levitas**. I am at a loss, Mr. Chairman. I just think it is demeaning that we have to subpena an agency of the Federal Government to do what the law requires them to do.

Mr. **Rosenthal**. I agree with you completely.

Mr. **Barash**. The alternatives are not very good ones. What we could do is proceed down the contempt of Congress road. That would require a vote of the subcommittee and the full committee, and then the entire House.

It is a difficult road to pursue. It is a very time-consuming road.

Barring that particular approach, there is not really much we can do to enforce the subcommittee's right to information.

Mr. **Rosenthal**. I agree with Mr. Levitas.

Mr. **Williams**. Mr. Chairman, I move that we do issue subpenas, as indicated in the record.

Mr. **Rosenthal**. The clerk will call the roll.

The **Clerk**. Mr. Rosenthal?

Mr. **Rosenthal**. Aye.

The **Clerk**. Mr. Matsui?

Mr. **Matsui**. Aye.

The **Clerk**. Mr. Atkinson?

Mr. **Rosenthal**. Aye, by proxy.

The **Clerk**. Mr. St Germain?

[No response.]

The **Clerk**. Mr. Conyers?

Mr. **Rosenthal**. Aye, by proxy.

The **Clerk**. Mr. Levitas?

Mr. **Levitas**. Nay.

The **Clerk**. Mr. Williams?

Mr. **Williams**. Aye.

The **Clerk**. Mr. Jeffries?

[No response.]

The CLERK. Mr. Deckard?

Mr. DECKARD. Aye.

Mr. ROSENTHAL. The clerk will report the results.

The CLERK. There are six ayes and one nay.

Mr. ROSENTHAL. The subpenas are issued.

Those two matters are concluded.

One of the things we might do is address a letter, signed by all the members of the subcommittee, to the Appropriations Subcommittee that deals with the CFTC and ask them to hold up their appropriations until the matter is satisfactorily resolved by the Congress. That could be done.

That is one thought. I do not think we need a motion, but if everybody is in agreement, I will direct the staff to do that. We will move expeditiously.

If there are no further questions or comments, we will go ahead with that. The subcommittee stands adjourned.

[Whereupon, at 11:50 a.m., the subcommittee was adjourned to reconvene subject to the call of the Chair.]

D. BENJAMIN S. ROSENTHAL LETTER TO MEMBERS OF THE COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE, MAY 14, 1980, WITH ATTACHMENT, "LETTER TO HOUSE APPROPRIATIONS COMMITTEE ON CFTC REFUSAL TO RESPOND TO CONGRESSIONAL REQUESTS FOR INFORMATION"

[illegible]

NINETY-SIXTH CONGRESS
Congress of the United States
House of Representatives
COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

[illegible]

May 14, 1980

MEMORANDUM

TO: All Subcommittee Members

FROM: Benjamin S. Rosenthal, Chairman

SUBJECT: LETTER TO THE HOUSE APPROPRIATIONS COMMITTEE

Attached is a copy of the final letter sent to the members of the Appropriations Committee with regard to the Commodity Futures Trading Commission.

BSR:bv

Attachment

NINETY-SIXTH CONGRESS

Congress of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

May 6, 1980

Dear Colleague:

The Commerce, Consumer and Monetary Affairs Subcommittee, Committee on Government Operations, is assigned oversight responsibility for the Commodity Futures Trading Commission (CFTC). As members of the subcommittee, we are writing to express our deep concern over the repeated failure of the Commission to comply with official subcommittee requests for futures market trading data essential to on-going investigations of CFTC operations and activities. This failure not only violates the broad rights of congressional committees and subcommittees, under the Constitution, to investigate matters assigned to them under House Rules, but a specific provision of the Commission's authorizing legislation (Section 8(e) of the Commodity Exchange Act) which mandates disclosure of all information to "any committee of either House of Congress acting within the scope of its jurisdiction."1/

It is the current position of a majority of the CFTC Commissioners -- but not its Chairman -- that:

(1) The disclosure mandate of Section 8(e) extends only to a full committee and bars disclosure to a subcommittee, even when the full committee has formally delegated to the subcommittee oversight jurisdiction for the CFTC; and

(2) Information and data will be furnished to a subcommittee only upon the issuance of a subpoena.

1/ Section 8(e) of the Act, as amended by the Futures Trading Act of 1978 (7 U.S.C. 12(e)) reads, in part, as follows: "Upon the request of any committee of either House of Congress, acting within the scope of its jurisdiction, the Commission shall furnish to such committee the names and addresses of all traders...and any other information in the possession of the Commission relating to the amount of any commodity purchased or sold by each such trader." (Emphasis added.)

The Commerce, Consumer and Monetary Affairs Subcommittee has repeatedly pressed on the CFTC its strong opposition to this interpretation of Section 8(e). Our protests have been rejected. Accordingly, it has been necessary, on two occasions during the 96th Congress, for the subcommittee to authorize subpoenas against the CFTC for documents essential to subcommittee investigations. These subpoenas have been complied with by the CFTC.[2]

Although the subcommittee does have authority, under House Rule - XI,2,(m), to authorize subpoenas, we believe that given the broad investigatory powers of Congress under the Constitution and the House Rules; and absent an express statutory prohibition to the contrary, agencies of the government should be required -- even absent a subpoena -- to make all relevant materials available to committees and subcommittees acting within the scope of their authority. In the case of the CFTC, not only is there no statutory prohibition against disclosure to the Congress, there is an express statutory mandate requiring it.

It is inappropriate that a subcommittee of the Congress, with a clear and specific grant of oversight jurisdiction from a full committee, should be forced to issue subpoenas for information from a Federal agency whose enabling authority requires it to furnish such information. In support of our position as to the CFTC, we specifically offer the following:

-- The position advanced by a majority of the members of the CFTC that Section 8 bars disclosure to a subcommittee, runs contrary to a long line of judicial decisions and congressional practice. Section 8 of the Commodity Exchange Act was enacted (after a dispute between the Senate Appropriations Committee and the Secretary of Agriculture), to enhance the ability of the Congress to investigate -- a function almost always performed by subcommittees. It makes no sense to create subcommittees, invest them with investigatory or oversight responsibility for particular Federal agencies or subject matter, and then permit a Federal agency to deny them information under a statute mandating disclosure of information to "committees".[3]

2/ On December 20, 1979, the subcommittee authorized a subpoena to the CFTC for miscellaneous documents relative to the subcommittee's investigation of allegations of manipulation in the cattle futures market. The Commission voted 3 to 1 to comply with the subpoena, Commissioner Gartner dissenting. Subsequently, Commissioner Gartner sued the subcommittee and the CFTC in Federal District Court for an injunction prohibiting delivery of the documents. Commissioner Gartner's motion for a temporary restraining order was denied after a hearing by U.S. District Court Judge Charles Richey. Judge Richey's opinion stated that Commissioner Gartner lacked standing to sue but stated that even if he did have standing, this case represents an instance when the doctrine of judicial abstention would be most appropriate and should be applied because of the broad public interest that favors the Congress of the United States and its duly authorized committees to perform their... function."

3/ In a January 3, 1980, letter to the Chairman of CFTC, Chairman Jack Brooks of the Committee on Government Operations wrote that the Commerce, Consumer and Monetary Affairs Subcommittee was specifically, by a vote of the full committee, assigned oversight jurisdiction for the Commodity Futures Trading Commission.

-- Moreover, the courts have long recognized that the term "committee" is frequently used generically in statutes to encompass "subcommittees". In Barenblatt vs. U.S. (240 F. 2d75, 1957), the U.S. Court of Appeals for the District of Columbia decided that a witness' refusal to answer questions before a subcommittee and pertinent to a subcommittee investigation, did violate 2 U.S.C. 192, which provides for criminal sanctions against persons who, having been summoned,"refuse to answer questions before...any committee of either House of Congress." (Emphasis added.) A unanimous court said:

> "It is also contended that the indictment is fatally defective in that it alleges a refusal to answer questions before a subcommittee of a committee, and that Congress did not intend to make it a crime to refuse to answer questions of a subcommittee....We disagree. Nothing has been shown which reflects that Congress has indicated such belief. We can only construe the statute in light of the obvious purpose for its enactment. That purpose was to discourage the impairment of the vital investigative function of Congress. The function Congress sought to protect is as often committed to subcommittees as it is to full committees of Congress, as indeed it must be. Construing the statute in a manner consistent with its obvious purpose...we hold that Congress intended the word 'committee' in its generic sense, which would include subcommittees."[4]

The unanimous opinion of the Court of Appeals in Barenblatt serves as a strong precedent for the subcommittee's interpretation of Section 8(e) of the Commodity Exchange Act. Using the language of Barenblatt, it is clear as to Section 8 that the "obvious purpose for its enactment", was to enhance the ability of Congress to obtain information and "discourage the impairment of the vital investigative function of Congress.... Construing the statute in a manner consistent with its obvious purposes," it is obvious that Congress intended the word "committee" in Section 8(e) "in its generic sense, which would include subcommittees."

We are bringing this matter to the attention of the House Appropriations Committee not only because of our belief that the CFTC will benefit from this subcommittee's oversight, but because we believe there is an important principle at stake here: Federal agencies are created by and derive their powers from the Congress. Congressional oversight is a vital function of the Congress, essential to legislating. Unless there is an explicit statutory provision which bars or limits congressional access to data from a Federal agency,[5] or unless a claim of Executive Privilege is alleged and can be sustained, these Federal agencies must be fully responsive to official requests by the committees and subcommittees of the Congress for all information

4/ The same conclusion was reached in other cases, including Johnson vs. McDonald, 269 So. 2d 683.

5/ For example, Section 6103(d) of the Internal Revenue Code explicitly limits congressional access to tax returns and tax return information to the Committees on Ways and Means of the House and Finance of the Senate and to the Joint Committee on Internal Revenue Taxation. Disclosure to any other committee requires a Resolution of the House of Representatives or of the Senate.

essential to the investigatory process. This is particularly so, when a provision of the authorizing statute so requires. The congressional subpoena process should be exercised only as a last resort when there is no other avenue for securing necessary information. Congress should not be required to expend the time and taxpayers' dollars required to enforce, through subpoena, its constitutional right to information from the agencies it creates.

The FY 1981 appropriation for the Commodity Futures Trading Commission is presently pending before your Committee. We respectfully request that the Appropriations Committee take appropriate action, including specific language in the CFTC's appropriations bill or, if necessary, a suspension of the appropriation itself, to cause the CFTC to comply forthrightly and completely with official requests for documents from congressional subcommittees acting within the scope of their authority.

We are also enclosing a recent opinion of the American Law Division, Library of Congress, which supports our position.

Sincerely,

Benjamin S. Rosenthal
Chairman

Lyle Williams
Ranking Minority Member

Robert T. Matsui

Eugene V. Atkinson

Fernand J. St Germain

John Conyers, Jr.

Elliott H. Levitas

APPENDIX 3.—REQUESTS TO AGENCIES, JUNE 10, 1980

A. BENJAMIN S. ROSENTHAL LETTER TO JAMES M. STONE, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

[illegible]

NINETY-SIXTH CONGRESS

Congress of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
[illegible]
[illegible]

[illegible]

June 10, 1980

Hon. James M. Stone, Chairman
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D. C. 20581

Dear Mr. Chairman:

As you know, the Commerce, Consumer and Monetary Affairs Subcommittee has held seven days of hearings to date on recent events in the silver markets, their impact on related financial markets and the supervision of these markets by the responsible Federal agencies.

The Rules of the House of Representatives assign to the Government Operations Committee broad investigatory authority for the operation and activities of all Federal agencies and for the effectiveness of the laws they administer. In addition, the committee has legislative jurisdiction for reorganizations in the legislative and executive branches of government and, in certain situations, for the establishment of new agencies of government.

This subcommittee is assigned specific oversight jurisdiction for the operations, activities and effectiveness of laws administered by the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), the Federal banking agencies including the Federal Reserve, and the Department of the Treasury including the IRS.

The regulatory responsibilities of each of these agencies have been seriously impacted by the recent collapse of the silver markets, an event which you characterized as "a situation of financial panic which could affect not only the commodities markets but the stock market and possibly financial institutions as well." Others have echoed your view.

The Commerce, Consumer and Monetary Affairs Subcommittee is deeply concerned that the activities of a handful of commodity speculators have had such a profound effect on our Nation's marketplace. It is ironic that such activity seems to have been least understood or monitored where agency jurisdictions most overlapped and markets were most closely interrelated.

To complete our hearing record and before we take final action (which could include a recommendation for the establishment of an "Interagency Market Regulatory Council" composed of the principals from the CFTC, SEC, Treasury and Federal Reserve), the subcommittee needs clarification of the testimony of Nelson Bunker and William Herbert Hunt. We asked the Hunts to testify and provide documentation on the nature and extent of their silver trading activities and the financing of those activities; on their relationships with other large traders and with commodity brokers, bankers and securities dealers; on their dealings with Federal regulators and commodity exchanges; and, on their use of foreign markets and exchanges.

We are providing you herewith a number of documents dealing with the Hunt's silver related activities, including: (1) the responses of Nelson Bunker and William Herbert Hunt to subcommittee interrogatories, (2) sworn statement of Mr. Bill Bledsoe, formerly vice president of Hunt Energy Corporation and personal assistant to Mr. Nelson Bunker Hunt and (3) a Hunt entities listing as of July 1978.

We are requesting that you carefully examine the information and data furnished by the Hunts and the sworn document of Mr. Bledsoe, together with information independently available to your agency, for any evidence of inconsistencies, or possible irregularities or violations of laws you administer.

Your response to the subcommittee should include, but not necessarily be limited to, answers to the following questions and should be sent to the subcommittee by July 30, 1980.

I

Mr. Bledsoe's statement describes aggregate trading practices by Hunt entities and trusts, including buying in the name of children, in-laws, friends and employees. He characterizes this trading in various ways, as part of a "plan," "strategy" or "in concert." (See pp. 7-8, 17-24, 33)

1. Which Hunts and Hunt entities did the CFTC treat in aggregate for reporting purposes in silver futures, as of August 1, 1979? As of June 1, 1980?

2. Summarize and attach supporting documents for futures trading by International Metals Investment Co., Ltd. (IMIC) from January 1979 to date, including number of contracts, position, month and exchange, and whether delivery occurred.

3. Under the Commodity Exchange Act and regulations, when were the Hunts first required to report to the CFTC positions they had through IMIC?

4. When were Hunt positions through IMIC actually first reported to the CFTC? Include number of contracts, position, month and exchange.

II

Attach documents which show the number of silver futures contracts by position, amount, month and exchange, and whether delivery occurred, for each of the persons or entities listed below on each of these six dates: January 1 and August 1, 1979; January 1, March 28, May 2 and July 25, 1980.

1. Nelson Bunker Hunt
2. William Herbert Hunt
3. Lamar Hunt
4. The total for persons and entities treated in aggregate by the CFTC described in I, 1, above.
5. IMIC
6. Profit Investment Company, Inc.
7. Naji Robert Nahas (Geneva, Switzerland)
8. Bangue Populaire Suisse (Geneva, Switzerland)
9. Norton Waltuch (New York)
10. Gillian Financial (Geneva, Switzerland)
11. ContiCapital Management, Inc. (Chicago)
12. ContiCapital Ltd. (Nassau, Bahamas)

III

Both the CFTC's May 1980 report on silver and Mr. Bledsoe's statement locate silver bullion owned by the Hunts personally in Swiss vaults. In addition, the CFTC maintains books and records on any cash transactions in the commodity by traders with a "reportable position."

1. For the persons and entities listed in II, 1-6, above, summarize the information and attach copies of CFTC records on cash transactions in silver between 1973 and July 1980, including parties, date, amount in ounces and physical location of the silver.
2. For the persons and entities listed in II, 7-12, above, summarize the information and attach copies of cash transactions in silver for 1979 and 1980 to date.
3. Summarize the present CFTC foreign trader reporting requirements and any revisions presently under consideration.

4. What is the CFTC's best estimate of the amount of actual silver presently owned or controlled by the Hunts and Hunt entities in aggregate? List persons and entities included in aggregate count.

5. What is the CFTC's best estimate of the amount of actual silver presently owned or controlled by each of the persons or entities listed in II, 7-12, above?

6. The Hunts testified before this subcommittee on May 2, 1980, that they shipped no actual silver out of this country. Mr. Bledsoe, however, describes shipments of silver from Chicago and New York to Zurich (p. 35). Summarize information the CFTC has on Hunt transfers of actual silver out of the country, and, if any, the amount of Hunt silver now estimated to be in the five Swiss banks and one vault described by Mr. Bledsoe (pp. 28-30).

IV

Mr. Bledsoe's statement described several instances when the Hunts made plans to impact the silver market and the value of their own silver holdings. He describes silver purchases through a publicly-held company which "drove the market up" (pp. 19-20) and a proposal the Hunts made to various OPEC officials for the purchase of silver with dollars from oil revenues (pp. 26-33). Mr. Bledsoe characterizes these actions as "a concerted attempt to manipulate or control the world's supply of silver" that "would cause Bunker Hunt and William Herbert Hunt's silver to increase in value." (pp. 30-31)

A central purpose of the Commission's market surveillance program is to detect threats of corners, manipulations or other major market disturbances. The elements of manipulation are generally considered to be

> "(a) a trader or group of traders who act in concert and have the capacity to affect the price of a commodity, (b) the exercise by that trader or group of traders of their capacity to affect the price, (c) an artificial price, and (d) intent." Report of the Commodity Futures Trading Commission, May 1980, at p. 15.

1. Summarize the information which the CFTC presently has on a possible corner or price manipulation in silver for each of the four elements listed above.

2. Summarize the relationships to date which the CFTC has found or established between any of the first six persons or entities in II and the second set of six.

3. Summarize any information the CFTC presently has on silver trading, ownership, and bullion transfers out of the country by each of the following entities:

    a. Multi-Projects, Ltd. (Caymen Islands)

    b. Advi Corp.

c. National Commodity and Barter Association

d. American Law Association

V

Summarize Commission and staff discussions, analyses and decisions to date on speculative limits in silver trading. Attach relevant documents, memorandum and staff opinions.

VI

Summarize and attach supporting documents of any Commission or staff discussions, analyses, investigations and reports on the use of the specific available enforcement tools(described on pages 12-14 of the CFTC's Report on Silver, May 1980) in silver futures trading since 1973.

If you have any questions, please contact subcommittee staff.

Sincerely,

Benjamin S. Rosenthal
Chairman

Attachments

B. BENJAMIN S. ROSENTHAL LETTER TO HAROLD M. WILLIAMS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

[illegible]

NINETY-SIXTH CONGRESS

Congreſs of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

[illegible]

June 10, 1980

Hon. Harold M. Williams, Chairman
Securities and Exchange Commission
500 North Capitol Street
Washington, D. C. 20549

Dear Mr. Chairman:

As you know, the Commerce, Consumer and Monetary Affairs Subcommittee has held seven days of hearings to date on recent events in the silver markets, their impact on related financial markets and the supervision of these markets by the responsible Federal agencies.

The Rules of the House of Representatives assign to the Government Operations Committee broad investigatory authority for the operation and activities of all Federal agencies and for the effectiveness of the laws they administer. In addition, the Committee has legislative jurisdiction for reorganizations in the legislative and executive branches of government and, in certain situations, for the establishment of new agencies of government.

This subcommittee is assigned specific oversight jurisdiction for the operations, activities and effectiveness of laws administered by the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), the Federal banking agencies including the Federal Reserve, and the Department of the Treasury including the IRS.

The regulatory responsibilities of each of these agencies have been seriously impacted by the recent collapse of the silver markets, an event which Chairman Stone of the CFTC characterized as "a situation of financial panic which could affect not only the commodities markets but the stock market and possibly financial institutions as well." Others have echoed that view.

The Commerce, Consumer and Monetary Affairs Subcommittee is deeply concerned that the activities of a handful of commodity speculators have had such a profound effect on our Nation's marketplace. It is ironic that such activity seems to have been least understood or monitored where agency jurisdictions most overlapped and markets were most closely interrelated.

To complete our hearing record and before we take final action (which could include a recommendation for the establishment of an "Interagency Market Regulatory Council" composed of the principals from the CFTC, SEC, Treasury and Federal Reserve), the subcommittee needs clarification of the testimony of Nelson Bunker and William Herbert Hunt. We asked the Hunts to testify and provide documentation on the nature and extent of their silver trading activities and the financing of those activities; on their relationships with other large traders and with commodity brokers, bankers and securities dealers; on their dealings with Federal regulators and commodity exchanges; and, on their use of foreign markets and exchanges.

We are providing you herewith a number of documents dealing with the Hunt's silver-related activities, including: (1) the responses of Nelson Bunker and William Herbert Hunt to subcommittee interrogatories and (2) a sworn statement of Mr. Bill Bledsoe, formerly vice president of Hunt Energy Corporation and personal assistant to Mr. Nelson Bunker Hunt, and (3) a Hunt entities listing as of July 1978.

We are requesting that you carefully examine the information and data furnished by the Hunts and the sworn statement of Mr. Bledsoe, together with information independently available to your agency, for any evidence of inconsistencies, or possible irregularities or violation of laws you administer.

Your response to the subcommittee should include, but not necessarily be limited to, answers to the following questions and should be sent to the subcommittee by July 30, 1980.

I

Mr. Bledsoe's statement describes aggregate trading practices by the Hunts, characterized in various ways as part of a "plan", "strategy" or done "in concert". (See pp. 7-8, 17-24, 33.)

1. Which Hunts and Hunt entities did the SEC treat in aggregate for reporting purposes as of August 1, 1979? As of June 1, 1980?
2. Assuming Mr. Bledsoe's description of the Hunts' trading to be accurate and using the attached Hunt entities list, when did aggregate Hunt ownership in Bache exceed the 5 percent limit which triggers the SEC 13-D reporting requirement?
3. Give the date actually filed and attach the 13-D form.
4. Using the attached entities list, what additional publicly-held and traded companies are 5 percent or more owned or controlled by aggregate Hunt interests?

II

Mr. Bledsoe describes certain business and trading practices by the Hunts in connection with several publicly-held companies (beginning on p. 37 of his statement). He suggests that the Hunt company Penrod Drilling, may have appropriated trade secrets while leased to Hunt Energy Competitors such as Chevron and Shell. In addition, while the Hunts controlled Great Western United and before it was taken private, the company may have traded commodities publicly in a way designed to benefit personal Hunt silver holdings (pp. 19-20); and a subsidiary of Great Western, Impel, may have given valuable oil information to Hunt Energy rather than its parent company.

1. Assuming Mr. Bledsoe's statement to be accurate, what potential violations of SEC-administered law are involved?

III

Attach the quarterly reports required by Section 13 or 15(d) of the Securities and Exchange Act of 1934 filed by the Bache Group Inc. for 1979 and the first two quarters of 1980. For each of those six dates, summarize the following information:

1. Under "Assets" the categories and amounts of the various "Securities and commodities" pledged as collateral for bank loans and letters-of-credit agreements used in any way for Hunt silver trading.
2. Under "Other Assets", the amount of silver and location.
3. Under "Liabilities", "Other Liabilities", those involved in any way with Hunt silver trading.
4. Under "Revenues", "Commodities", the amount of silver and location.
5. Under "Contingent Liabilities", the amount of bank guarantees and letter-of-credit agreements used in lieu of margin deposits for commodity trading.
6. The amount in this same category (five above) specifically for silver trading.
7. The amount in the same category (five above) specifically for the Hunts' trading.

IV

Attach quarterly reports for the same six time periods for the following brokerage firms:

a. ACLI International
b. E. F. Hutton
c. Mocatta Metals
d. Heinold Commodities Inc.
e. Merrill Lynch
f. Paine Webber
g. Clayton Brokerage Co.
h. Dean Witter Reynolds
i. A. G. Edwards
j. Shearson, Loeb, Rhodes
k. Cargill Investor Services
l. ContiCommodities Services, Inc.

For each of the firms, summarize the same information requested in 1-7, III, above.

If you have any questions, please contact subcommittee staff.

Sincerely,

Benjamin S. Rosenthal
Chairman

BSR:tv

Attachments

cc: Mr. Stanley Sporkin

C. BENJAMIN S. ROSENTHAL LETTER TO BENJAMIN R. CIVILETTI, ATTORNEY GENERAL, DEPARTMENT OF JUSTICE

[illegible]

NINETY-SIXTH CONGRESS

Congreſs of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS

RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. [illegible]

June 10, 1980

Hon. Benjamin R. Civiletti
Attorney General
Department of Justice
Washington, D. C. 20530

Dear Mr. Attorney General:

The Subcommittee on Commerce, Consumer and Monetary Affairs has been conducting an investigation of and has held seven days of hearings into recent events in the silver markets, their impact on related financial markets and the supervision of these markets by the responsible agencies.

The Rules of the House of Representatives assign to the Government Operations Committee broad investigatory authority for the operation and activities of all Federal agencies and for the effectiveness of the laws they administer. In addition, the committee has legislative jurisdiction for reorganizations in the legislative and executive branches of government and, in certain situations, for the establishment of new agencies of government.

This subcommittee is assigned specific oversight jurisdiction for the operations, activities and effectiveness of laws administered by the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), the Federal banking agencies including the Federal Reserve, and the Department of the Treasury including the IRS.

The regulatory responsibilities of each of these agencies have been seriously impacted by the recent collapse of the silver markets, an event which Chairman Stone of the CFTC characterized as "a situation of financial panic which could affect not only the commodities markets but the stock market and possibly financial institutions as well." Others have echoed that view. The Commerce, Consumer and Monetary Affairs Subcommittee is deeply concerned that the activities of a handful of commodity speculators have had such a profound effect on our Nation's marketplace.

During the course of our investigation, the subcommittee made contact with a Mr. Bill Bledsoe who, until late 1979, was a vice president of Hunt Energy Corporation and a senior aide to Nelson Bunker Hunt. During the course of discussions with Mr. Bledsoe, it became clear that he possessed information of direct importance to the subcommittee's investigation. Accordingly, by letter dated May 8, 1980, I advised Mr. Bledsoe that information in his possession was essential to the subcommittee's investigation and I requested that he give the subcommittee a sworn statement setting forth his knowledge of Hunt activities falling within the parameters of the subcommittee's inquiry.

On May 23, 1980, Mr. Bledsoe responded to subcommittee questions and attested to the truth of his statements. A copy of Mr. Bledsoe's sworn statement is attached. I am also attaching a verbatim transcript of the sworn testimony of Mr. Nelson Bunker Hunt and Mr. William Herbert Hunt before the Commerce, Consumer and Monetary Affairs Subcommittee on May 2, 1980.

A number of statements attested to by Mr. Bill Bledsoe directly contravene statements made under oath by one or the other or both of the Hunt brothers. For example,

-- Mr. Bledsoe stated that the Hunt brothers traded silver "in concert." He swore that "The silver transactions are made by William Herbert Hunt and Nelson Bunker Hunt in concert. They buy and sell silver together. It is more than just having lunch together or 'we work in the same building'. The business of Hunt Energy Corporation, the first order of business is silver. The markets are reviewed daily." (Page 18 of the Bledsoe's transcript.) Bledsoe's statement is in direct contrast to the sworn testimony of the Hunts before the subcommittee that they traded only as individuals and not in concert.

-- Bledsoe stated that, "The Hunts were making a concerted attempt to manipulate or control the world's supply of silver" (page 30), by purchasing silver for themselves and in the names of others (i.e., employees, in-laws, Hunt controlled corporations, etc.); and by enlisting individuals in the Middle East and elsewhere to purchase silver with them. One result of this effort was the establishment of International Metals in Bermuda, jointly owned by the Hunts and some Saudi Arabian businessmen. During the subcommittee's hearings, the Hunts testified under oath that they in no way attempted to manipulate or corner the silver markets.

-- Bledsoe stated that, "The Hunts had many planeloads of silver flown from New York City and Chicago to Switzerland. I didn't actually see the airplanes take off loaded with silver, but it was the general talk around the Hunt companies that such was being done. In fact, I was told that the Hunts enlisted ranch hands from their cattle ranches in Texas to ride shotgun on the transfers." (page 34) During their subcommittee testimony, the Hunts denied that any silver was shipped out of this country to Switzerland or elsewhere.

-- Bledsoe stated that there were, "Several instances" in which Hunt entities were put into a tax shelter after the fact. He indicated that one instance involved Nelson Bunker Hunt's son, Houston Hunt, who allegedly made $9 million in the soybean market in 1977-1978: "So Nelson Bunker Hunt came to me and instructed me to put his children into drilling deals, and I told him the wells had already started drilling. And he told me, 'You put them in there anyway.' So we had to rearrange the contract so at least the lawyers had to redo the contracts so that these entities would be placed into the drilling wells which would give them write-offs." (page 24) This allegation, if verified, could constitute a civil or criminal violation of the tax laws.

-- Bledsoe stated that the Hunts were apprised on a daily basis of their silver positions. This contradicts the Hunts' sworn testimony that they did not keep careful track of their silver dealings.

The subcommittee does not possess the investigative resources to verify and confirm the allegations contained in Mr. Bledsoe's sworn statement. Nevertheless, because of the numerous and serious discrepancies between the Hunts' sworn testimony and the statements provided the subcommittee and attested to by Mr. Bledsoe, I am requesting that the Department of Justice initiate an investigation to determine whether there has been a violation of Federal civil or criminal laws within your jurisdiction, including 18 USC 1621, the perjury provision of the Criminal Code.

I would greatly appreciate your keeping the subcommittee closely advised on the progress and results of your investigation.

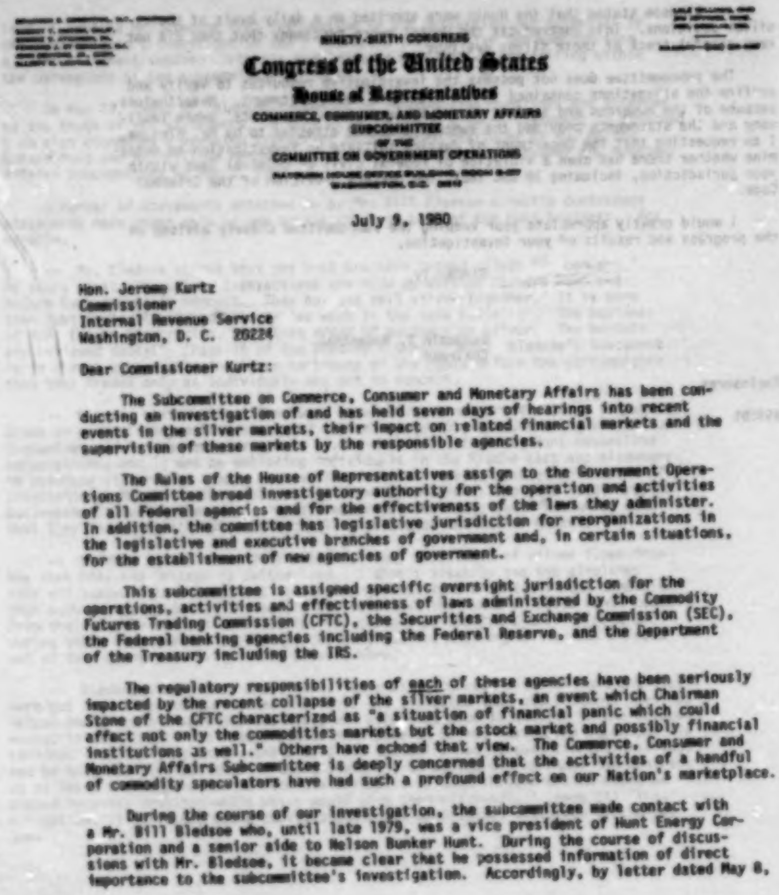
Sincerely,

Benjamin S. Rosenthal
Chairman

Enclosures

BSR:bt

D. BENJAMIN S. ROSENTHAL LETTER TO JEROME KURTZ, COMMISSIONER, IRS, DATED JULY 9, 1980



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NINETY-SIXTH CONGRESS

Congress of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM [illegible]
WASHINGTON, D.C. [illegible]

[illegible]

July 9, 1980

Hon. Jerome Kurtz
Commissioner
Internal Revenue Service
Washington, D. C. 20224

Dear Commissioner Kurtz:

The Subcommittee on Commerce, Consumer and Monetary Affairs has been conducting an investigation of and has held seven days of hearings into recent events in the silver markets, their impact on related financial markets and the supervision of these markets by the responsible agencies.

The Rules of the House of Representatives assign to the Government Operations Committee broad investigatory authority for the operation and activities of all Federal agencies and for the effectiveness of the laws they administer. In addition, the committee has legislative jurisdiction for reorganizations in the legislative and executive branches of government and, in certain situations, for the establishment of new agencies of government.

This subcommittee is assigned specific oversight jurisdiction for the operations, activities and effectiveness of laws administered by the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), the Federal banking agencies including the Federal Reserve, and the Department of the Treasury including the IRS.

The regulatory responsibilities of each of these agencies have been seriously impacted by the recent collapse of the silver markets, an event which Chairman Stone of the CFTC characterized as "a situation of financial panic which could affect not only the commodities markets but the stock market and possibly financial institutions as well." Others have echoed that view. The Commerce, Consumer and Monetary Affairs Subcommittee is deeply concerned that the activities of a handful of commodity speculators have had such a profound effect on our Nation's marketplace.

During the course of our investigation, the subcommittee made contact with a Mr. Bill Bledsoe who, until late 1979, was a vice president of Hunt Energy Corporation and a senior aide to Nelson Bunker Hunt. During the course of discussions with Mr. Bledsoe, it became clear that he possessed information of direct importance to the subcommittee's investigation. Accordingly, by letter dated May 8, 1980, I advised Mr. Bledsoe that information in his possession was essential to the subcommittee's investigation and I requested that he give the subcommittee a sworn statement setting forth his knowledge of Hunt activities falling within the parameters of the subcommittee's inquiry.

On May 23, 1980, Mr. Bledsoe responded to subcommittee questions and attested to the truth of his statements. A copy of Mr. Bledsoe's sworn statement is attached. I am also attaching a verbatim transcript of the sworn testimony of Mr. Nelson Bunker Hunt and Mr. William Herbert Hunt before the Commerce, Consumer and Monetary Affairs Subcommittee on May 2, 1980.

A number of statements attested to by Mr. Bill Bledsoe directly contravene statements made under oath by one or the other or both of the Hunt brothers. For example,

-- Mr. Bledsoe stated that the Hunt brothers traded silver "in concert." He swore that "The silver transactions are made by William Herbert Hunt and Nelson Bunker Hunt in concert. They buy and sell silver together. It is more than just having lunch together or 'we work in the same building'. The business of Hunt Energy Corporation, the first order of business is silver. The markets are reviewed daily." (Page 18 of the Bledsoe's transcript.) Bledsoe's statement is in direct contrast to the sworn testimony of the Hunts before the subcommittee that they traded only as individuals and not in concert.

-- Bledsoe stated that, "The Hunts were making a concerted attempt to manipulate or control the world's supply of silver" (page 30), by purchasing silver for themselves and in the names of others (i.e., employees, in-laws, Hunt controlled corporations, etc.); and by enlisting individuals in the Middle East and elsewhere to purchase silver with them. One result of this effort was the establishment of International Metals in Bermuda, jointly owned by the Hunts and some Saudi Arabian businessmen. During the subcommittee's hearings, the Hunts testified under oath that they in no way attempted to manipulate or corner the silver markets.

-- Bledsoe stated that, "The Hunts had many planeloads of silver flown from New York City and Chicago to Switzerland. I didn't actually see the airplanes take off loaded with silver, but it was the general talk around the Hunt companies that such was being done. In fact, I was told that the Hunts enlisted ranch hands from their cattle ranches in Texas to ride shotgun on the transfers." (page 34) During their subcommittee testimony, the Hunts denied that any silver was shipped out of this country to Switzerland or elsewhere.

-- Bledsoe stated that there were, "Several instances" in which Hunt entities were put into a tax shelter after the fact. He indicated that one instance involved Nelson Bunker Hunt's son, Houston Hunt, who allegedly made $9 million in the soybean market in 1977-1978: "So Nelson Bunker Hunt came to me and instructed me to put his children into drilling deals, and I told him the wells had already started drilling. And he told me, 'You put them in there anyway.' So we had to rearrange the contract so at least the lawyers had to redo the contracts so that these entities would be placed into the drilling wells which would give them write-offs." (page 24) This allegation, if verified, could constitute a civil or criminal violation of the tax laws.

-- Bledsoe stated that the Hunts were apprised on a daily basis of their silver positions. This contradicts the Hunts' sworn testimony that they did not keep careful track of their silver dealings.

The subcommittee does not possess the investigative resources to verify and confirm the allegations contained in Mr. Bledsoe's sworn statement. Nevertheless, because some of Mr. Bledsoe's statements about Hunt operations and activities raise serious law enforcement questions within your agency's jurisdiction, I am requesting that you review the attached materials for evidence of violations of Federal tax laws.

I would greatly appreciate your keeping the subcommittee closely advised on the progress and results of your investigation.

Sincerely,

Benjamin S. Rosenthal
Chairman

BSR:tv

Enclosures

E. SWORN STATEMENT OF BILL BLEDSOE, FORMER VICE PRESIDENT OF HUNT ENERGY CORP., DATED MAY 23, 1980

PROCEEDINGS

Ms. Timmer. Today the staff of the Commerce, Consumer, and Monetary Affairs Subcommittee will hear from Bill Bledsoe, a former employee of the Hunts, as part of our continuing investigation into the adequacy of Federal response to events in the silver and related financial markets.

The rules of the House of Representatives assign to the Government Operations Committee broad investigatory power for the operation and activities of all Federal agencies and for the effectiveness of the laws they administer.

The committee is authorized to conduct "investigations of any matter without regard to" the jurisdiction of other standing committees and it is mandated to make its investigatory findings and recommendations available to those committees.

When the Government Operations Committee held its organizational meeting for the 96th Congress, this subcommittee was assigned specific oversight jurisdiction for the operations, activities and effectiveness of laws administered by the Commodity Futures Trading Commission, the Securities and Exchange Commission, the Federal banking agencies, including the Federal Reserve and the Department of the Treasury, including the IRS.

The regulatory responsibilities of each of these agencies have been seriously impacted by events prior and subsequent to the recent collapse of the silver market.

When CFTC Chairman James Stone testified before the subcommittee recently he characterized this event "a situation of financial panic which could affect not only the commodities markets but the stock market and possibly the financial institutions as well."

This subcommittee has oversight responsibility for each of the Federal agencies that supervise these far-flung but interrelated financial markets.

Our investigation required the direct and detailed testimony from Nelson Bunker and William Herbert Hunt on the nature and extent of and reasons for their silver trading activities and the financing of those activities, their relationships with other large traders and with commodity brokers, bankers and securities dealers, their use of foreign markets and exchange, and the regulatory and financial relief they sought from Federal officials.

Both Nelson Bunker and William Herbert Hunt appeared before the subcommittee on May 2, 1980, and responded to a number of questions raised by subcommittee members.

Today's staff meeting with Bill Bledsoe is for the purpose of clarifying and completing the record of Hunt acitivities which the Hunts themselves started on May 2.

Would you swear the witness?

The Reporter. Do you solemnly swear to tell the truth, the whole truth, and nothing but the truth?

Mr. Bledsoe. I do.

Ms. Timmer. The record should also reflect that in the room is Mr. Bledsoe's attorney, Hugh Smith, also from Dallas, Texas.

Mr. Bledsoe, you understand that you are not here to give your legal opinions on the Hunt activities; is that correct?

Mr. Bledsoe. That is correct. I am here actually at the request of the subcommittee and under advice of my counsel, Mr. Hugh Smith of Dallas, Texas.

Ms. Timmer. For what reasons and purposes?

Mr. Bledsoe. Mr. Smith and I in the past 2 to 3 weeks, upon reading articles in the newspapers, particularly the Dallas Morning News and The New York Times and The Wall Street Journal, noticed articles concerning William Herbert Hunt and Nelson Bunker Hunt and their responses to the government committee here in Washington.

We find that the statements that we have heard William Herbert Hunt and Nelson Bunker Hunt made are not in agreement with our understanding of their role in the silver market, silver futures, and the silver play.

Since I have had a role with the Hunts for the past 15 years, and in fact was involved in the silver dealings of the Hunts, I felt that I should clearly define the role that I had personally as it related to the Hunts as I was acting as their employee at the time, working for both Nelson Bunker Hunt and William Herbert Hunt, and I would like to just make this perfectly clear as my role in the relationship with them which is not in agreement with the responses that the Hunts made to the government committee as I see it.

Ms. Timmer. May I include your résumé in the record?

Mr. Bledsoe. Yes.

Ms. Timmer. Would you summarize your employment relationship with the Hunts?

Mr. Bledsoe. I was first employed with the Hunts and when I say the Hunts, the Hunts are the family of H. L. Hunt. This is the first family of H. L. Hunt and it includes a list of perhaps 200 entities or organizations.

In that list are corporations, partnerships, limited partnerships, joint ventures, trusts, corporations and individual accounts and foundations.

Ms. Timmer. Do you have that list with you?

Mr. Bledsoe. There is such a list, yes. It lists over 200 such accounts. These accounts are maintained presently under one organization which is called Hunt Energy Corp. which acts as a service company and as an umbrella corporation for all the other entities.

To answer your question, I started with Placid Oil Corp. in 1965 in the oil part of the business.. I was a petroleum land man which meant that I bought oil leases for Placid Oil Co. chiefly in Louisiana.

I, later, after being with Placid Oil Corp., was asked to do certain projects for H. L. Hunt—special projects—who was the father of Nelson Bunker Hunt and William Herbert Hunt and Lamar Hunt and such projects involve the management of oil properties and the management of land.

I assisted Mr. H. L. Hunt in disposing of food plants and factories which he owned throughout the United States and I did other various activities of a personal nature for H. L. Hunt.

At that time I lived in Shreveport, La. I later moved to Dallas, Tex. and continued working for Placid Oil Corp. but also worked personally for H. L. Hunt.

Shortly before Mr. H. L. Hunt's death in 1974, I was asked to do certain services for Nelson Bunker Hunt which were actually started in July of 1973. After this first venture or first duty with Nelson Bunker Hunt, which involved the purchase for his personal account of 100,000 or 120,000 acres of fee land in southeastern Oklahoma, it led to a role that I played with Nelson Bunker Hunt personally on all of his investments, including horses, cattle, oil and gas, real estate, avocados, silver, cotton, soybeans, sugar, and a diverse amount of activities such as that.

Ms. Timmer. Did you perceive Nelson Bunker Hunt as a leader in the family, the person who ran the day-to-day activities of the umbrella organization?

Mr. Bledsoe. Yes. Let me come back to the question. Let me just finally say—and then I will get off my personal deal—in 1973, Mr. Hunt's properties in Libya had been nationalized and had been confiscated, and he was out of the oil production business in the Middle East.

At that time I encouraged Mr. Hunt to enter the domestic oil and gas business which he had been away from for several years. I felt that the domestic oil and gas business merited his attention and I mentioned this and encouraged him to commence exploration for oil and gas in the United States.

At the time oil was about $3 a barrel. He thought it was a good idea but oil then was too cheap, but he said to see him when oil reached $9 a barrel. Shortly thereafter it increased to over $9 a barrel and he then agreed it was the right time to enter the oil exploration business in the United States.

I wrote him a letter recommending that we form a new corporation, which was Hunt Energy Corp., and embark on a program of oil and gas exploration in a very aggressive manner using only the best of people that the industry could provide. In fact, Mr. Hunt carried out my recommendation. That is when Hunt Energy Corp. was formed in 1975.

Shortly before the formation, Mr. Hunt's father, H. L. Hunt, died. There was a dividing of the properties between the first family of H. L. Hunt, the second family and the third family, and as it turned out Hunt Energy Corp. is the parent corporation for the first family.

What was your other question there?

Ms. Timmer. Was Nelson Bunker Hunt, in your opinion, from a day-to-day working relationship with him, the family leader or perceived by the first family as the manager of the umbrella corporation as well as the 200 or so entities which you have described?

Mr. Bledsoe. Without question, Nelson Bunker Hunt is the leader of the Hunt entities. He took over this leadership shortly after his father's death. He is the big brother, so to speak, and the other family members follow Nelson Bunker Hunt's wishes and direction.

Ms. Timmer. During the entire length or term of your employment with the Hunts—and I understand you left in March of 1979—was there any question raised by any of the Hunts as to your business competency, the trust placed in you or even any questions of illegalities on your part?

Mr. Bledsoe. None whatsoever. As a matter of fact, I was the first employee of Hunt Energy Corp. which was founded around myself and Nelson Bunker Hunt at the same time William Herbert Hunt formed the corporation with us, and within 2 years approximately, I was made a vice president—Nelson Bunker Hunt appointed me—and I have total authority to do and say things for Nelson Bunker Hunt with, of course, his approval.

There is no question of my competency or legality or anything of the nature at the time.

Ms. Timmer. So that we have this on the record, let me ask you now—and your attorney is here also, and I understand your answers may have to be restricted somewhat—what is the present relationship that you have with your former employer?

Mr. Bledsoe. May I go off the record?

[Discussion off the record.]

Ms. Timmer. Mr. Smith, do you want to answer that question?

Mr. Smith. I can answer it only from the legal point of view, that is, that shortly after Mr. Bledsoe's resignation from Hunt Energy, he became under immediate attack from the Hunt entities, claiming that he had engaged in conflict of interest, had diverted monies to his own use, had pirated employees away to the detriment of Hunt Energy Corp. and had breached the fiduciary relationship with HEC, Hunt Energy Corp., and Nelson Bunker Hunt.

This lawsuit was brought in the names of Hunt Energy Corp., Nelson Bunker Hunt Trust, and Nelson Bunker Hunt as an individual.

The present status of that suit is, it is scheduled for trial—which I don't think it will come to as of the date it's scheduled—and we are in a status of discovery with both sides taking depositions.

Mr. Bledsoe filed a countersuit against the same entities, and it's just following the normal course of litigation at this point.

Ms. Timmer. What does the countersuit allege?

Mr. Smith. A deliberate attempt on the part of the Hunt Energy Corp. and agents, particularly Nelson Bunker Hunt and William Herbert Hunt, of seeking to undermine, discredit and slander Bill Bledsoe in his dealings with other entities in the oil and gas industry.

Mr. Bledsoe. I might add, if you don't mind, that this is not an isolated case in respect to William Herbert Hunt and Nelson Bunker Hunt for ex-employees, particularly key employees that leave the Hunt organizations. Very often they are immediately attacked by the Hunts in such a manner. Many of the other key people that have left have experienced harassment from private detectives, alleged slanderous statements made about them, and I am just one of many who have been harassed in attempts to discredit. This has happened to me from the Hunts, so it is a normal course of action that they apparently tend to follow.

They seem to have a reputation in the oil industry of being very litigious. As some people would say, they will sue at the drop of a dangling participle. Unfortunately, that is the reputation that they have.

Ms. Timmer. Let's get back to the substantive topics that we want to have your opinions and understandings about today, which include, first of all, our interest in Hunt silver dealings; second, the relationship between Hunt entities and the Hunt trusts; and third, the oil business that you are most familiar with, and how that brought you into contact with both the trusts and the silver dealings.

First of all, would you just briefly describe for those of us unfamiliar with the Hunt empire, the trusts which were set up for the first family and the relationship between those trusts and Placid Oil, Hunt Energy, and any of the other major Hunt entities.

Mr. Bledsoe. The trusts were set up under the will of the Hunt boys' mother, Lyda Bunker Hunt, who died in the early fifties. She was a very great lady and had a lot of vision, and she set up these trusts for each of the children, the first one being the Hassie Hunt Trust Estate, the Margaret Hunt Hill Trust Estate, the Nelson Bunker Hunt Trust Estate, the William Herbert Hunt Trust Estate, the Lamar Hunt Trust Estate, and the Caroline Hunt Sands (later Schoellkopf) Trust Estate.

These trusts were set up each having a trustee who was not the beneficiary and an advisory committee of usually three persons.

Ms. Timmer. For each trust?

Mr. Bledsoe. For each trust. Each trust had a different trustee and a different beneficiary. The beneficiary being named in the trust. In other words, for Nelson Bunker Hunt Trust, Estates, the sole beneficiary would be Nelson Bunker Hunt.

As the trusts are administered, it is tightly controlled by either family members, family lawyers, or employees.

Ms. TIMMER. What is the role and function of and who serves on the advisory committees?

Mr. BLEDSOE. The advisory committee—each one of the trusts are more or less dovetailed in that one, Lamar Hunt, for example, may serve on the board of the advisory committee of Hassie Hunt Trust and Bunker Hunt might serve on William Herbert's board and Margaret's. It is all dovetailed and tightly controlled by the Hunt family. It would seem that the trusts would be an independent entity, but as a matter of fact it is operated totally by the family and the decisions are made by the beneficiary, the decisions of the trusts are made by the beneficiary and not by the trustee. The trustee is usually a figurehead and the advisory committees merely ratifies the decisions actually made by the beneficiaries.

Ms. TIMMER. Can you give a couple of day-to-day concrete examples that you might have seen in the operation of the Hunt enterprises of how those advisory committees, beneficiaries and trusts were interrelated?

Mr. BLEDSOE. What comes to mind immediately is a transaction in 1974 that I personally made for Nelson Bunker Hunt. I had recommended a purchase of a real estate property northwest of Tulsa, Oklahoma, involving about 16,000 acres. I thought the property was very attractive, had a good future, and had a lake that it bordered, and it was very close to Tulsa, which was a growing community.

Mr. Hunt and myself went to Tulsa personally and I bought the property in my name, Bill Bledsoe, Trustee, and only Bunker Hunt and myself knew about this. As I was about to transfer legal title over to Nelson Bunker Hunt, instead he and I got together and he decided it should go into Nelson Bunker Hunt Trust Estate instead. That is the way I made the deed, the Nelson Bunker Hunt Trust Estate, and payment was made from the Nelson Bunker Hunt Trust Account.

The trustee at this time was Mr. Ralph Shank of Dallas, who was Mr. Hunt's attorney.

We had not consulted with the trustee at all. The advisory committee I believe at the time was Mr. John Goodson, Margaret Hunt Hill, and one of the other Hunt members. Of course, we did not consult with the trustee or the advisers, and we merely made the transaction ourselves and it was a $4.2 million—a sizable transaction—but we did this without consulting anyone. Hunt made the decision, put it in the legal entity that he wanted. The only people we consulted with would have been his personal accountant, to see what the money was that he had available in his own personal account and the money in this trust estate account at that particular time.

What I am saying is he makes the decisions for himself. He also makes the decisions for his trust estate. No one else is consulted other than perhaps his accountant to see what amount is in his bank account.

The decisions are merely ratified by the trustee and the advisory board.

Mr. SMITH. May I interject and ask a question at this point?

Ms. TIMMER. Let's have this off the record.

[Discussion off the record.]

Ms. TIMMER. Back on the record.

Mr. Bledsoe, is the 1974 purchase that you just described and the resulting manner in which that was handled for the Nelson Bunker Hunt Trust Estate, a kind of singular exception, or is that general practice for the Hunts in your knowledge?

Mr. BLEDSOE. It is definitely not a single exception and it is clearly the accepted practice. I know of no instance where the advisory committee or the trustee of any of these trusts ever made a decision or a recommendation that properties or interest be bought or sold. This is always done by the beneficiary whether it be the William Herbert Hunt Trust Estate or whatever, the beneficiary makes the decisions. The only exception is the Hassie Hunt Trust Estate which is not controlled by Hassie Hunt, a man who has been very ill since the late 1940's.

Ms. TIMMER. As far as you know, are there non-Hunt employees on any of these advisory committees?

Mr. BLEDSOE. The advisory committees and the trustees are in every case made up of, number one, family members, either a brother or sister or a nephew or a Hunt lawyer from the Shank Irwin law firm or a long-time trusted Hunt employee. So the trusts are manipulated strictly by the first family of the Hunts.

To take it one step further, the gem of the Hunt crown of oil companies is Placid Oil Corp. This company is owned by these individual trust estates. Placid is owned by Nelson Bunker Hunt Trust Estate, William Herbert Hunt Trust Estate, Caroline Hunt Schoellkopf Trust Estate, Margaret Hunt Hill Trust Estate, and Lamar Hunt Trust Estate. Hassie Hunt Trust Estate is not an owner. The ownership is roughly 20 percent each. Some would have 17, some 22 percent, but across the board is it approximately one-fifth each owned by these trust estates.

Placid does have a president who is merely a figurehead president. It is tightly controlled by the beneficiaries of these trust estates, and predominately Nelson Bunker Hunt and William Herber Hunt, personally.

At times, the other voice that is heard in the Placid decisionmaking is Margaret Hunt Hill. She sometimes takes a role, but mostly Placid is controlled and directed by William Herbert Hunt and Nelson Bunker Hunt.

Ms. TIMMER. Did you have an opportunity to read the testimony of William Herbert Hunt and Nelson Bunker Hunt as it was presented to this subcommittee on May 2, 1980?

Mr. BLEDSOE. I have.

Ms. TIMMER. Do you have a copy of that that you can look at?

Mr. BLEDSOE. I do.

Ms. TIMMER. Because we are talking about this topic right now, I would like to go over with you some questions I have about that testimony and then you may want to clarify any additonal points.

On page 8 of the testimony, you can see that the subcommittee understood that Nelson Bunker Hunt and William Herbert Hunt would testify "fully and completely and otherwise cooperate with the subcommittee's investigation."

You have mentioned your concern that the Hunts had not testified fully and completely. After reading the testimony, the total testimony of the Hunts, what is your opinion based on the years of your employment relationship with the Hunts?

The subcommittee is not looking for a legal opinion here but a general opinion based on your working experience.

Mr. BLEDSOE. The testimony, as it appears to be, appears generally to be an intent to mislead the committee. It is not my place to say whether or not the statements made therein are false; I would say they are not clear and not correct. It appears to be an intent by the Hunts to mislead the committee.

Ms. TIMMER. Do you think that some of your answers will clarify the record for the subcommittee?

Mr. BLEDSOE. I think possibly so, I particularly want to clearly define any role that I might have had in any of this silver speculation, because I would definitely think it is speculation, and I think that something needs to be said, so that the role of the Hunts and their intent and position in silver might be made known.

Ms. TIMMER. Particularly as it may reflect on your own business or career?

Mr. BLEDSOE. That is correct. I am in the oil and gas business. I am presently president of an energy company known as Bledsoe Energy Corp. I feel that I must take these steps under advice of my counsel to protect not only myself but my business interests also.

Ms. TIMMER. Thank you.

Let's look at page 18 where my first question arose. William Herbert Hunt suggests there, using his own words, "Let me make it very clear I look after my own investment in silver. I do not stay appriсed of what my brothers own."

And on page 22, in response to a question from Chairman Rosenthal, "There is no joint venture or joint enterprise or joint partnership?" William Herbert Hunt responds, "That is true."

What is your own understanding of the working relationship between Nelson Bunker Hunt and William Herbert Hunt?

Mr. BLEDSOE. Apparently William Herbert Hunt has failed to remember the day-to-day transactions that are done by William Herbert Hunt and Nelson Bunker Hunt. The silver transactions are made by William Herbert Hunt and Nelson Bunker Hunt in concert. They buy and sell silver together. It is more than just having lunch together or we work in the same building operation. The business of Hunt Energy Corp., the first order of business is silver. The markets are reviewed daily by Herbert and Bunker, usually in Herbert's office.

Ms. TIMMER. The first order of Hunt Energy Corp.?

Mr. BLEDSOE. As it pertains to Nelson Bunker Hunt and William Herbert Hunt is silver. Silver is looked at as the first order of business in the morning and it is discussed by the two gentlemen, William Herbert Hunt and Nelson Bunker Hunt. It is then reviewed throughout the day. They have other interests, yes, but silver is first and prime in their minds.

The strategy is determined daily on whether Bunker and Herbert will buy or sell in their own names or in family names, in corporate names.

Ms. TIMMER. Did they ever buy silver in names other than their own or other than Hunt entities?

Mr. BLEDSOE. I believe you will find that they also bought in the name of International Metals, Investment Corp., a Bermuda corporation and Profit Investment Corp. I think you shall find that they bought in the name of C. W. Smith, Ted Curtain, and Alvin Brodsky.

Ms. Timmer. Who is C. W. Smith?

Mr. Bledsoe. He is a personal friend of Nelson Bunker Hunt.

Ms. Timmer. Who is Ted Curtain?

Mr. Bledsoe. He is a horse trainer for Bunker Hunt; resides in the country of Ireland. Brodsky is a silver broker of Bunker and Herbert.

They also buy in the names of their children, they buy in the names of their sons and sons-in-law. For example, Albert Huddleston is a son-in-law of Nelson Bunker Hunt. There are other sons-in-law. Paul Flowers.

Ms. Timmer. When you say they buy in their names, do you mean they suggest, this is a good investment, and the person to whom they are talking goes out and buys, or do you mean that the Hunts——

Mr. Bledsoe. It's actually a plan that these parties get together and decide when to buy silver, when is a good time to buy, and they buy in concerted effort which has a major effect on the market, and you could back this up to 1974–1975 when they at the same time were buying in the name of a public company, a New York Stock Exchange listed company, Great Western United Corp.

The Hunts owned 61 percent of this New York Stock Exchange Company, and they were placing Great Western United Corp., a public company in the market after the Hunts had personally been in it first.

Ms. Timmer. Did that influence the market?

Mr. Bledsoe. Certainly it influenced the market upward with such large purchases of silver at one time coming from the Hunts and it naturally drove the market up.

Ms. Timmer. On page 69 of the transcript, William Herbert Hunt in response to a question states that all his futures purchases of silver were disclosed to the Commodities Futures Trading Commission. Do you have any knowledge of your own that any purchases of futures contracts by either Nelson Bunker Hunt or William Herbert Hunt were not disclosed to the Commodity Futures Trading Commission? Did you ever hear that discussed or do you know that of your own knowledge?

Mr. Bledsoe. I have no knowledge of that.

[Discussion off the record.]

Ms. Timmer. In several different places in the testimony beginning on page 18 really, William Herbert Hunt said he doesn't stay apprised of what his brother does and later during the questioning both of the Hunts said they did not know the extent of their silver ownership, or the extent of their particular losses or gains at various points in time. Did you find that in general during your employment with the Hunts that was the way they handled their business, or did you find that they did have an awareness of their positions, say, in silver at any point in time?

Mr. Bledsoe. The Hunt brothers, William Herbert Hunt and Nelson Bunker Hunt particularly, are very brilliant individuals. They are astute businessmen in that they know exactly what their position is in silver and oil and gas, in cattle, in horses, in real estate. They have phenomenal memories. They can tell you what they paid for an acre of land 12 years ago. They do not do business haphazardly although they do take great risks. They conduct their business on a planned attack whether it is to buy or sell. They know precisely the amount of silver they have at any given moment. They could tell you precisely what they paid for silver in February 1974. They have this type of mind—phenomenal minds.

Ms. Timmer. Do they also have records?

Mr. Bledsoe. Not only do they have phenomenal memories but they have documents that are fed to them daily by their personal accountants and the cashier of Hunt Energy Corp.

Ms. Timmer. Who are their personal accountants?

Mr. Bledsoe. Mr. William Herbert Hunt's personal accountant is Don Sellner. Mr. Nelson Bunker Hunt's personal accountant is Bill Reed. It was Bill Reed. I think since I left, he has been changed.

They use the same tax manager, James L. Parker.

Ms. Timmer. Who was the cashier?

Mr. Bledsoe. The cashier who keeps up with all the silver dealings is Charles Mercer. Not only does he keep up with Bunker Hunt's dealings and Herbert Hunt's, he also keeps up with Lamar's dealings, with the dealings of other family members, with the dealings of the international corporation in Bermuda, or whatever entity.

Ms. Timmer. In silver specifically?

Mr. Bledsoe. In silver, in soybeans. The Hunts had the same problem in soybeans where they overbought and they said that they did not buy together. But not only did they buy together but their family members bought together. Of course they bought together. They bought in concert.

Ms. Timmer. When you say there was day-to-day silver recordkeeping by Charles Mercer, do you mean that there were actually documents or records on a regular basis supplied to the Hunts?

Mr. Bledsoe. Definitely. It is a matter of good business to know what your position is and certainly the Hunts are good businessmen. They could tell you today what they own.

Ms. Timmer. But did you see these records?

Mr. Bledsoe. I saw regular records in the course of business, yes, that the Hunts would refer to, but I don't know that it is an astounding revelation to see that Hunts kept records of their silver purchases. You have to do that for tax purposes.

Also the Hunts' tax manager is Jim Parker. He knows exactly where they are in silver because he has to do the tax planning and he is, by the way, a trustee for Nelson Bunker Hunt Trust Estate. He is also trustee of Hassie Hunt Trust and president of Hassie Hunt Exploration Company, also of Prosper Energy Corp., Pursue Energy Corp. and other Hunt entities.

Tom Hunt, who is a cousin of Nelson Bunker Hunt and William Herbert Hunt also is kept apprised daily of the silver position of the Hunts.

Ms. Timmer. Why?

Mr. Bledsoe. He is in an advisory capacity and presently president of Hunt Energy Corp., and he advises them, not so much as to silver dealings but more on the oil and gas needs of the Hunt corporations.

Ms. Timmer. When you talk about Jim Parker the tax manager, and Charles Mercer who kept records, including the silver records, were there discussions or transactions that did take place with tax purposes in mind?

Mr. Bledsoe. Certainly all business decisions among the Hunt corporations, trusts and individuals had tax reasons behind them as a matter of good business.

The Hunt Energy Corp was a vehicle to invest tax money into oil and gas drilling programs. If a certain individual or trust or entity of the Hunts needed to have tax money, this entity would be put into a particular drilling well or prospect as the need would arise for tax purposes.

Ms. Timmer. Let me ask you something. Of your own knowledge, were there ever any transactions where a Hunt entity was put into a tax shelter of some sort after the fact?

Mr. Bledsoe. As a matter of fact, there would be several instances, particularly in wells that were being drilled in Louisiana, Texas, and North Dakota, the ones that I can recall.

Ms. Timmer. Can you describe some of those examples for us?

Mr. Bledsoe. In particular that I recall offhand, Mr. Nelson Bunker Hunt's son, Houston Hunt, and his daughters made several million dollars, approximately $9 million more or less, in the soybean market in 1977-1978, made huge profits; and you are talking about a son who is 21 or 20 years old at the time. All of a sudden he had nine million bucks while a freshman at Tulsa University.

So Nelson Bunker Hunt came to me and instructed me to put his children into oil and gas drilling deals, and I told him the wells had already started drilling. And he told me, "You put them in there anyway."

I told him the contract is already signed, the wells are drilling. He said, "I want them in there." The lawyers had to rearrange the contracts so that these particular Hunt entities or individuals would be placed into the drilling wells which would give them tax writeoffs.

Ms. Timmer. You are not a tax attorney?

Mr. Bledsoe. Not at all. Nor an attorney at all.

Ms. Timmer. Were those documents transferred and changed——

Mr. Bledsoe. I merely passed along Mr. Bunker Hunt's, Herbert Hunt's or whoever it would be, instructions to the attorneys and the tax people, and they would do the necessary documentation and make the necessary changes.

Ms. Timmer. You don't have to answer this if you would rather not, but are some of these business practices that you describe part of the underlying reason that you eventually left the Hunt enterprises?

Mr. Bledsoe. These types of practices were one of the key reasons, along with some other similar type questionable activities which I did not particularly endorse, that necessitated my leaving the employ of Hunt.

Ms. Timmer. Let me ask you some questions now specifically about silver and some of the international transactions that you entered into for the Hunts.

You said that you first had some dealings with the Hunts in silver starting in 1973.

Mr. Bledsoe. I became aware in 1973 of Mr. Hunt, particularly Nelson Bunker Hunt's role in silver. Mr. Hunt, Nelson Bunker and William Herbert and Lamar Hunt were and had been receiving huge amounts of money from Libya as a result of their oil concessions in that country from the Giant Sarir oil field. As a matter of fact, within a year after the Hunts were confiscated in Libya they needed to do something with a large amount of cash settlement that they were getting which was one reason for Nelson Bunker Hunt enlisting my services to buy property in southeastern Oklahoma.

At the same time, I became aware of Nelson Bunker Hunt and William Herbert Hunt buying in the silver market. I came to work for Nelson Bunker Hunt and William Herbert Hunt. In 1975, in March, Nelson Bunker Hunt asked that I go on a trip with him to the Middle East.

Mr. Nelson Bunker Hunt and I journeyed to Teheran, Iran, on or about March 15, 1975. As we had arranged ahead of our journey, Prince Mahmoud Rezi Pahlavi had arranged an audience with the Shah of Iran for Nelson Bunker Hunt and myself. We arrived in Teheran and were met by Prince Mahmoud and were advised at this time that the Shah had other pressing business and would be unable to visit with Nelson Bunker Hunt and myself.

However, an audience had been arranged for us with the Minister of Finance, Mr. Ansari, out at Mr. Ansari's villa on the edge of Teheran.

We were impressed with Mr. Ansari since he had a few days before visited with the Secretary of State, Henry Kissinger, on a large international transaction involving weapons and petroleum.

We met with Minister Ansari, Nelson Bunker Hunt, myself and Mr. Ansari, and as we had planned before, Nelson Bunker Hunt requested that the Royal Family of Iran, the Pahlavi family, purchase with approximately 30 days supply of petroleum an equivalent amount in silver.

Ms. Timmer. Excuse me. Do you mean they would purchase the oil and silver or they would require payment in silver?

Mr. Bledsoe. They would actually purchase silver. Mr. Nelson Bunker Hunt stated that he did not necessarily want to sell or dispose of any of his own personal silver but that he thought that the Royal Family should acquire silver themselves because the dollar was so unreliable at that time, and that in the United States, at least, gold could not be purchased but silver could be, and Mr. Hunt advised and recommended silver as a hedge against inflation.

Ms. Timmer. How would that have worked? What kind of approximate amounts are involved?

Mr. Bledsoe. I haven't really calculated the total amount that would have been involved. I do know at that particular time Nelson Bunker Hunt had advised myself and Minister Ansari that presently this was in March of 1975—Nelson Bunker Hunt and William Herbert Hunt owned more than 50 million ounces of silver, either owned it or controlled it.

Ms. Timmer. Was the proposal that the Royal Family take the proceeds that they received in dollars from approximately 30 days worth of oil sales and purchase silver themselves?

Mr. Bledsoe. That was the plan.

Ms. Timmer. Where were they to purchase the silver?

Mr. Bledsoe. They were to purchase the silver either on the U.S. market or in the London market, and storage could be arranged in Switzerland which was the main storing place of the Hunt's silver.

After the meeting in Teheran, Nelson Bunker Hunt and myself flew to Zurich, Switzerland. From Zurich we planned to go to Jedda to visit King Faisel with the identical proposal. We called from Zurich a contact in New York City, a Mr. Ben Friedman, who was to arrange an audience for us with King Faisel. Mr Friedman advised us that the entire Middle East was aware of Nelson Bunker Hunt's presence in Iran, and that it would not "look right" for Bunker Hunt to then go to Saudi Arabia as a second choice, and recommended that Mr. Hunt return to Dallas, Texas, wait 2 weeks and then go directly to Saudi Arabia to see King Faisel and an appointment would be made for him by Mr. Friedman.

We elected to take Mr. Friedman's advice. Mr. Hunt proceeded to Paris, France, where he had a number of thoroughbred horses, and then on to Dallas, Texas.

My instructions were to stay in Zurich, Switzerland, and spend a week visiting the banks in Zurich to talk with them concerning the storage of silver, the purchase of silver, the silver market in general and the possible financing of additional silver by Swiss banks.

Ms. Timmer. Can you give us the details on each of those?

Mr. Bledsoe. I was instructed by Bunker Hunt to call William Herbert Hunt and get the names of the banks that I should visit in Zurich. Then Mr. Hunt left me in Zurich for Paris. William Herbert Hunt told me to see the Union Bank of Switzerland, a Mr. Bruno Saga.

I was also to see the Credit Swiss Bank: I don't recall the gentleman's name there. I was also to see the Swiss Bank Corp., Mr. Fritz Haueter and a Mr. Henry Kyburg, Union Bank of Switzerland and another bank called the Banque Suisse Populaire, and a fifth bank that I cannot recall at the present time.

Ms. Timmer. Do you have a name for the person you talked with at the Banque Suisse Populaire?

Mr. Bledsoe. I do not at this time.

Ms. Timmer. Can you get us the names of the persons you talked to at Credit Swiss and the last two banks?

Mr. Bledsoe. I will attempt to do that.

Herbert Hunt advised me at this time that any transactions regarding silver in Iran could be made through the Omiran Bank through the, as my notes reveal, Penlavi Foundation, which is not spelled exactly like the Pahlavi family.

Herbert Hunt also made a specific request that I arrange for additional storage of silver bullion in Switzerland. The Hunts at that time had such large amounts of silver bullion in storage that they could not find enough vaults for the silver.

I was to arrange for silver storage with the bank or find other areas to store silver. In particular, Herbert Hunt asked that I see Friedlager, which was a warehouse at the Zurich Airport.

Herbert Hunt requested that I ask each of the banks if they would finance more silver purchases for the Hunts. They, Bunker and Herbert Hunt, wanted to buy approximately 25 to 30 million ounces more silver at that particular time, or perhaps as much as $100 million worth. They wanted the banks to loan up to 75 to 80 percent on the silver against perhaps warehouse receipts in the United States, short-term loans of 90 days at as low interest rates as possible.

I visited with each of the banks, was very well received. I had a card at the time that said Bill L. Bledsoe, Special Representative, Nelson Bunker Hunt, and the moment the card was received by the bank presidents, I would be immediately shown in to the president of the bank. They all knew William Herbert Hunt. They all knew Bunker Hunt and know of their large positions in silver.

As I saw it at the time the Hunts were making a concerted attempt to manipulate or control the world's supply of silver.

Ms. Timmer. By themselves or with other people as well?

Mr. Bledsoe. Initially with themselves. When Bunker Hunt and I went to the Middle East after discussing our trip with Herbert, silver was somewhat around $5 which was low. Our trip was at the time to cause silver to react into an upward movement. We wanted to stimulate the price of silver upwards.

Ms. Timmer. How would that be accomplished?

Mr. Bledsoe. By getting the Iranians or the Saudi Arabians to buy into the silver market and to take large positions in it. This would cause Bunker and William Herbert Hunt's silver to increase in value.

Ms. Timmer. Did you visit Saudi Arabia?

Mr. Bledsoe. Nelson Bunker Hunt returned to Texas and after my week's trip to Zurich, Switzerland, I returned to Texas also, and we received notice from Mr. Friedman that we had an appointment with King Faisel within the next 10 to 14 days.

I went on vacation to a small farm that I have in West Virginia, and I received a call at my farm in West Virginia from one of the Hunt associates, advising me that a friend of mine had passed away, to which I asked who is that, and he said King Faisel had been assassinated. Therefore, this ended the present plans of Nelson Bunker Hunt and William Herbert Hunt to enlist the support of the Saudi Arabians because the country was in a state of confusion and unrest.

Ms. Timmer. As a result of your meetings with the Iranian officials, were any deals completed or any positions taken by those individuals in the silver market?

Mr. Bledsoe. Not at that time. We did not give up on the plan to enlist Middle East participants in silver, as you will see later. I returned to Iran in July of 1978 and once again visited with the Royal Family on behalf and at the instructions of Nelson Bunker Hunt and William Herbert Hunt to see if they would reconsider the Hunts recommendation to buy silver.

In the same year, 1978, I arranged a meeting in Washington, D.C. on some other business with the Prime Minister of New Zealand, Mr. Muldoon.

At that meeting was to be Nelson Bunker Hunt, William Herbert Hunt, the Chairman of the Board of Phillips Petroleum Co., Mr. William Martin, myself, and another distinguished gentleman from Texas, Governor John Connally.

The meeting with the Prime Minister of New Zealand did not involve silver, it involved drilling operations of the Hunts and the Placid Oil Corp. and Impel, owned by Great Western United. The purpose of the meeting was to seek a relief of taxation that the New Zealand Government was imposing on our oil and gas exploration activities, $3 per barrel tax.

Governor Connally attended this meeting as Mr. Hunt's attorney. Shortly after the meeting, we were advised by Governor Connally that Khalid Ben Mahfouz was at the hotel, the same hotel where we were, and Bunker Hunt and Herbert Hunt had previously told Governor Connally of their desire to meet this wealthy gentleman from Saudi Arabia. Governor Connally was very well acquainted with him, and took us by Mahfouz's suite, which consisted of the entire floor of this particular Washington hotel, complete with 30 or 40 security guards, to meet this gentleman from Saudi Arabia.

Ms. Timmer. What was the purpose of that meeting?

Mr. Bledsoe. The purpose of this meeting was to enlist not only Ben Mahfouz but later another gentleman named Gabe Pharone into buying silver along with the Hunts.

Governor Connally had other ties with the Saudi involving activities in Texas, in Georgia, and the plan was to get the Hunts in the front door with these very wealthy Arab sheiks and the Hunts would sell the Saudi on the value of silver over the worthless paper U.S. dollar.

Later, not particularly out of this meeting, but later out of such introductions to Arab sheiks, as Bunker and Herbert Hunt were able to enlist the participation of Saudi Arabian money in the silver market one of which is the corporation in Bermuda, International Metals Investment Corp.

Ms. Timmer. Is that the only corporation in which the Hunt-Saudi Arabian interests were merged formally?

Mr. Bledsoe. It is the only one I know of. This corporation became such an active entity that Mr. William Herbert Hunt and Mr. Nelson Bunker Hunt's personal attorney, who was also attorney for Hunt Energy Corp., moved to Bermuda—his name is Robert Guinn—and set up the Bermuda corporation and did the transactions and the day-to-day buying, selling, and handling of silver for this corporation from Bermuda in concert with the day-to-day activities—personal purchases of Nelson Bunker and Herbert Hunt, Lamar Hunt, and other family members and trusts in Dallas.

Ms. Timmer. What was the date, if you recall, approximately of when IMIC was set up?

Mr. Bledsoe. It was 1979, about the summer of 1979.

Ms. Timmer. Were the Hunt purchases from then on primarily with or through IMIC?

Mr. Bledsoe. The Hunt purchases would continue. Their personal speculation or investing from Dallas, and at the same time carrying on the corporate silver activities from Bermuda.

[Brief recess.]

Ms. Timmer. Mr. Bledsoe, another area of questions which the subcommittee pursued with the Hunts involved whether or not there were physical transfers of silver out of the United States as opposed, for example, simply to exchange of receipts.

To your knowledge, were there any physical transfers out of the United States by either of the Hunts or any Hunt entity during your employment?

Mr. Bledsoe. It was my understanding that Bunker and Herbert Hunt had many plane loads of silver flown from New York City and Chicago to Switzerland. I didn't actually see the airplanes take off loaded with silver, but it was generally known around the Hunt companies that such was being done.

The Hunts enlisted ranch hands from their cattle ranches in Texas to ride shotgun on the transfers. It seemed to be a Hollywood dramatic event. The cowboys from the Circle K ranch near Kaufman, Texas, had pistol target practice to qualify as a silver guard.

Ms. Timmer. Who would have arranged those transfers, do you know?

Mr. Bledsoe. At the time, a brother-in-law, Randy Krieling, was in charge of the transfers along with his brother, Tim Krieling, under the direction of Nelson Bunker Hunt and William Herbert Hunt.

Ms. Timmer. Approximately what was the time period?

Mr. Bledsoe. The time period?

Ms. Timmer. That you are talking about.

Mr. Bledsoe. It took place in a matter of two weeks. You mean the year?

Ms. Timmer. Right.

Mr. Bledsoe. It would be 1974—early 1975.

Ms. Timmer. Were there any other transfers that you are aware of during your employment?

Mr. Bledsoe. Other than there might have been swaps or exchanges of silver. For example, William Herbert or Nelson Bunker would exchange silver in the United States for silver in London with some parties which would be an exchange of perhaps warehouse receipts or something of this nature, but it would amount to speculations in silver in the United States versus the value of silver in London; investing or speculating.

Ms. Timmer. Was there ever a time when because of the silver transactions any of the Hunt companies, for example, Hunt Energy or Placid Oil, had a cash flow problem?

Mr. Bledsoe. As a matter of fact, in 1975 the position that William Herbert Hunt and Nelson Bunker Hunt had achieved in silver placed a dire strain upon their own personal oil and gas investments, whereas, they would have normally had a large interest in the oil and gas drilling activities, they had to reduce this interest to such a great extent that they could not participate in some of the more attractive drilling prospects of the oil and gas business.

In particular, I can recall in 1975 when I purchased at the direction of Nelson Bunker Hunt and William Herbert Hunt a very prospective oil lease near Baton Rouge, Louisiana, called Profit Island—very appropriately called Profit Island.

We had information from Penrod Drilling Co., owned by Hunt, that Chevron Oil Co. had a gas discovery well to the southwest of Profit Island in False River Field, and I bought a lease on Profit Island from a Swedish match group, on very attractive terms, and to cover the draft or check that I issued for the oil lease on approximately 2,500 acres, an amount of cash amounting to approximately half a million dollars to be put in the First National Bank of Dallas. Because of the cash shortage of William Herbert Hunt and Nelson Bunker Hunt, we had to allow some of the other Hunt entities—the Hunt Petroleum Corp. (which is also owned by the same trust estates as Placid Oil Co.) and Hassie Hunt Exploration Co., and Caroline Hunt Trust Estate—to buy this lease and own this valuable asset.

As a result, Hunt later drilled a $5 million well in cost on the lease and discovered oil and gas in great quantities, and the property today is worth approximately a billion dollars, but, unfortunately for Bunker and Herbert personally it is owned by these other Hunt accounts.

What I am telling you is that silver and their large position in silver and the desire of Nelson Bunker Hunt and William Herbert Hunt to maintain this position and increase this position, in order to do so the oil and gas business took a back seat in their operations.

Ms. Timmer. Speaking of the relationship between the oil and gas businesses and the Hunt's interest in silver, would you discuss a little bit the use by the Hunts of IMPEL and even Penrod in terms of how those companies were controlled by the Hunts?

Mr. Bledsoe. Penrod Drilling Company is one of the largest drilling companies in the world, perhaps the largest. They have approximately 100 rigs. Some of these rigs are land rigs valued at five to ten to twelve million dollars each. Some of the rigs are semi-submersible operating in offshore waters. They would be worth fifty to sixty million dollars each. They have five of them. One of the rigs I operated very closely with in New Zealand, could drill a well in 2,300 feet of water. After drilling in 2,300 feet of water, approximately a half-mile depth, it can still be drilled fifteen to seventeen thousand feet below the surface, a tremendous piece of machinery. They had five of these operating in the North Sea and Dubai, Argentina, Brazil, and the Gulf of Mexico.

They also have several jackup rigs which would cost a lesser amount but still valued at twenty-five to thirty million dollars, which would operate in the North Sea and the Gulf of Mexico and the Gulf of Dubai and perhaps in South America. Penrod is a worldwide operation.

Ms. Timmer. Are these rigs leased?

Mr. Bledsoe. These are leased out to other companies and are also used by the Hunt companies in drilling their own wells at times. Rental on a semi-submersible rig would be fifty-five to sixty thousand dollars a day, and lesser amounts for other smaller rigs, giving Penrod a tremendous cash flow.

Ms. Timmer. Were these rigs ever leased by competitors?

Mr. Bledsoe. They would be leased to competitors such as Chevron, Shell, Exxon, Texaco, to drill their own wells, offshore wells, and land wells.

Ms. Timmer. Were there ever any conflicts of interest?

Mr. Bledsoe. The conflicts that I would list—and this was a major reason for my departure from the Hunt organization—is that on different instances a Penrod rig owned by Hunt would be drilling a well for Chevron and if Chevron encountered hydrocarbon shows this information was a closely held secret, privileged only to Chevron. However, if Penrod was the contracting rig on this well, the information would be immediately passed to the Hunts by Penrod, and on many occasions the Hunts would take advantage of the secret information to compete with Chevron in buying the oil and gas leases near the propective well or buy top leases and other attractive properties before Chevron could acquire the acreage.

Hunt had such a small but by extremely active oil and gas organization they could move faster and buy property faster than Chevron.

Another company where this was taken advantage of by Hunt was Shell Oil Company. I am particularly talking about areas in the Tuscaloosa Trend of Baton Rouge, Louisiana.

Ms. Timmer. Do you mean that the Hunt entity would actually get the information first?

Mr. Bledsoe. They would get it normally even prior to the contracting company, and the Hunts were looking for this key information and knew how valuable the information was and what to do with it. It was such key, hot and timely information that they would take advantage of it immediately. In one instance we had as many as 25 petroleum landmen buying leases over a weekend on information that we secured on a Shell Oil Company well which was secret or confidential to be given only to Shell Oil Company.

This, by the way, bothered many of the other Hunt employees, and the result is that Hunt lost several employees, myself included, resulting from such clandestine and improper activities.

Ms. Timmer. How about IMPEL Company which was owned by Great Western United; can you describe first the relationship between Great Western United and the Hunts and then the entity IMPEL itself, and the use by the Hunts of IMPEL?

Mr. Bledsoe. The Hunts took a large postion in a large conglomerate known as Great Western United Corporation in 1974. And after they acquired their initial interests they decided to take over the company because the Hunts were not satisfied with the present management. Nelson Bunker Hunt became chairman of the board. William Herbert Hunt became president. The Hunts owned 61 percent of the corporation, which was listed on the New York Stock Exchange.

They immediately saw a great amount of profit that Great Western was making, and they decided to form an oil and gas entity to drill up, so to speak, some of these profits that the corporation was going to make to avoid taxes and therefore they formed IMPEL Corporation headquarters of Denver, Colorado, and pirated many geologists, geophysicists, landmen, engineers, from other companies like Amoco, Exxon, and Texaco, and formed an oil and gas arm of the sugar company.

About the same time they also put the Great Western United into the commodities market.

Ms. Timmer. In what year was this?

Mr. Bledsoe. 1974–75. Great Western commenced being very active in buying sugar, soybeans and silver.

Ms. Timmer. Great Western bought silver?

Mr. Bledsoe. Yes. In fact, as I recall, huge profits, about a $40 million worth profit in silver.

The only conflict that I saw with IMPEL was that Hunt would many times use the information of Impel Corporation, information which was generated by IMPEL's internal geologists, geophysicists and landmen. The best of the information was passed on to Hunt Energy Corporation, which was a 100 percent owned Hunt company, and Hunt would be given the first step on buying prospective oil and gas leases and attractive oil properties in such highly prolific geological areas as the Overthrusts Belt of Wyoming, Idaho, Utah, and Montana and the Williston Basin of North Dakota.

Ms. Timmer. Who financed IMPEL?

Mr. Bledsoe. IMPEL was financed totally by the Great Western United Corporation. Great Western United Corp. was later taken private by the Hunts and it is now privately owned by William Herbert Hunt and Nelson Bunker Hunt and is known as Hunt International Resources Corporation. Its ownership includes some other companies that are familiar—Shakey's Pizza Parlors and Anchor Post Company. An unsuccessful attempt was made to acquire Sunshine Mining Corp.—a leading U.S. producer of silver. Hunt International Resources Corp. also owns real estate development companies in California, New Mexico, and Colorado.

Ms. Timmer. Did Hunt International Resources have an office in London?

Mr. Bledsoe. No. Hunt International Resources Corp did not, but other Hunt companies shared the same office in London on Sloan Street, with Placid International Petroleum Corp., Penrod Drilling Company, World Championship of Tennis, Hunt International Petroleum-United Kingdom, Hunt International Petroleum Company of Great Britain, and some of the Nelson Bunker Hunt horse operations in London were handled to some degree out of this office.

Also the Libyan operations of Hunt International Petroleum was also channeled through this office.

Ms. TIMMER. And Placid Oil?

Mr. BLEDSOE. This London office was based at the same headquarters, the same general address, although Placid's main office in Europe was the Placid International Petroleum Corporation office in The Hague, in The Netherlands.

Ms. TIMMER. Would you discuss the Placid Oil operations in The Netherlands and in Germany and in particular some of the investments by Germans in Hunt Enterprises.

Mr. BLEDSOE. In the late 1960's, early 1950's Placid Oil Company discovered an oil and gas field in north Louisiana called the Black Lake Field in Natchitoches Parish, Louisiana, which had a daily production of approximately 20,000 barrels of oil per day and an equivalent amount of gas was produced from the reservoir but was reinjected into the field so as to maintain a constant pressure on the flow of the oil. The field was discovered in 1964 and only recently did Placid start selling gas from the field but had been selling oil since 1965.

As a result of the Black Lake Field, which doubled the size of Placid Oil Corporation, at the time, Placid had a tremendous cash flow, and this enabled Placid to embark on other areas of exploration of oil and gas, and in particular, international operations.

One of the properties Placid became involved in in 1970 or the late 1960's was the L-10 Field offshore Holland in the North Sea.

Ms. TIMMER. The Netherlands?

Mr. BLEDSOE. Yes, offshore Netherlands in the North Sea.

Placid discovered a very substantial gas field located about 60 miles offshore Holland at Den Helder.

After developing the field for 5 or 6 years, the gas field was finally brought into production in about 1978 and is presently producing somewhere around 400 million cubic feet of gas per day. This gas is tied to the price of No. 2 fuel oil and is by contract sold 50 percent to The Netherlands and 50 percent to West Germany. As a result, Placid has a tremendous increase in cash flow, which is the reason that Placid has been buying substantial positions in Gulf Resources Corp., Louisiana Land Exploration Co. and all similar entities in which Placid has been buying stock. As a matter of fact, Placid, as a result of Bunker and Herbert's influence, became active in these several silver related corporations.

As a further connection with Placid's activity in Holland and West Germany, Hunt Energy Corporation in 1977—again as a result of Bunker and Herbert Hunt's activities in the silver market—experienced an acute cash shortage (in 1977 was prior to the cash flow of the Holland gas field), and to continue the drilling operations of Hunt Energy Corporation and at the same time maintain their position in the silver market, Bunker and Herbert Hunt, through Hunt Energy Corporation, brought in a German investment group from Hamburg, Germany, Nordeutshche Vermogensanlage GmbH & Co. This group was closely tied to the Jacobson shipping firm in Hamburg, but also was a money-raising and money-generating investment fund throughout West Germany, in particular in the cities of Cologne, Munich and Hamburg, for private investors of a large magnitude.

The proposed cost for the German investor was $30 million, and this money would be infused into the Hunt drilling program so that the West German interests could participate in drilling ventures in the United States and hopefully earn or own oil and gas interests in the attractive drilling areas in the United States.

This partnership with Hunt was known as Great American Exploration Corporation headquartered in New York City, and the First International Bank Building of Dallas, Texas, with their European office in Hamburg, Germany.

Ms. TIMMER. Sunshine Mining is another corporation with silver-mining holdings. Can you describe the Hunt relationship with Sunshine Mining?

Mr. BLEDSOE. Approximately one year after the acquisition of the 61 percent interest in Great Western United Corporation and at the same time taking their large silver speculation position, the Hunts became interested in Sunshine Mining Corporation, which had the largest, or the second largest, single mine in Idaho in the United States, being Kellogg, Idaho. The Hunts acquired a substantial position in Sunshine Mining, somewhere around 14 percent interest, and then attempted to take over or acquire complete control of Sunshine Mining.

One of the Hunt directors of Great Western United, the operating officer, Mr. Michael Boswell, was placed in charge of Sunshine Mining Corporation, and for one reason or another a proxy fight was had with Sunshine Mining and then a fight was had among the board of directors of Sunshine Mining and William Herbert Hunt and Nelson Bunker Hunt, and they were in and out of the courthouse.

As it turned out, the Hunts lost control of Sunshine Mining and at the same time lost Mr. Michael Boswell, a very key officer of the corporation, of Great Western United, and he is in fact now the president and chief operating officer of Sunshine Mining Company and the Hunts have no interest in that company.

Ms. Timmer. Sunshine Mining proposed a while ago that they might offer a silver bond issue, and in March of this year Nelson Bunker Hunt and some of the others announced a similar although slightly different version with even more silver involved from overseas. Did you have any relationship with or knowledge of these silver bond issues, their purpose or function?

Mr. Bledsoe. I had nothing to do with it. The only knowledge I had was through the press. I would not think that the two would have been in concert with one another since the Hunts are not getting along well with Sunshine Mining.

Ms. Timmer. Let me ask you something. You were furnished with a copy of a May 9 letter which was addressed both to Nelson Bunker Hunt and William Herbert Hunt. Did you have a chance to read that letter?

Mr. Bledsoe. Yes.

Ms. Timmer. From your operating knowledge of the Hunt entities and your employment experience, would you say that the Hunts should be able to answer these questions for the subcommittee?

Mr. Bledsoe. The information is available in the Hunt files.

Ms. Timmer. Is some of this information, for example, available through the monthly computer listings of Hunt properties?

Mr. Bledsoe. It would be available from the monthly listing. I don't know if the properties are on a computer as such, but at least the Hunts get a typewritten position statement from the respective accountants at Hunt Energy Corporation.

Ms. Timmer. Would it include the amount of actual silver in ounces owned or controlled by each of the entities listed in the May 9 letter?

Mr. Bledsoe. They get a detail or at least a monthly recapitulation sheet or summary sheet of what is going on in the various accounts. So this information would be available, yes.

Ms. Timmer. It would include the amount of actual silver in ounces?

Mr. Bledsoe. Yes.

Ms. Timmer. Would it include the number of futures contracts both long and short, for example?

Mr. Bledsoe. Certainly.

Ms. Timmer. Forward contracts for silver?

Mr. Bledsoe. Yes.

Ms. Timmer. Would the information available to Nelson Bunker Hunt and William Herbert Hunt include the nature and extent of their financial interests or investment in brokerage firms or corporations which own or control brokerage firms?

Mr. Bledsoe. Certainly it would include this. As a matter of good business, this information would be available to them at their instruction.

Ms. Timmer. Would the information available to the two Hunts also include their liabilities?

Mr. Bledsoe. Of course.

Ms. Timmer. And they would be able to say, for example, what was owed by each of them personally as well as by the various Hunt entities, to brokerage firms?

Mr. Bledsoe. Yes.

Ms. Timmer. To banks?

Mr. Bledsoe. Yes. You will notice that even the Hunts supplied the committee with charts and different calculations on what silver has done throughout the years. Certainly, if they are charting silver, you can rest assured they have charts and records of their own position.

Ms. Timmer. You had left their employment by the time this most recent silver market collapse occurred. That is true, isn't it?

Mr. Bledsoe. That is correct.

Ms. Timmer. So information about 1980 is not from personal knowledge but from what you have read?

Mr. Bledsoe. From what I have read; or I still have personal contacts within the company, personal friends within the company, and I am friends with some of their friends so this is the way I keep up.

I had, of course, an interest in the Hunts' position in silver. As I see it, the Hunts' problem in the silver market is they started believing their own information that they were intentionally disseminating and one of their big problems is that they operate under the thought that you should not ever sell anything because one day it might become valuable.

This is quite a position to take, and not many people or entities can afford to take such a position.

Ms. **Timmer**. I want to say the subcomittee certainly appreciates the information that you have shared with us today. Are there any additional points that you would like to have in the record that you have thought about that perhaps we have not covered today?

Mr. **Bledsoe**. I am only surprised that the Hunts, particularly William Herbert Hunt's statements that he did not deal or trade with his brother Nelson Bunker Hunt. It is definitely a fact that they did trade as speculators in concert with one another in an attempt to dominate silver and apparently manipulate the silver market.

Their world position in silver is a fact. I don't understand why they would make such misleading statements to the committee to disguise the fact that they trade in silver together, and I am also shocked at the statements made by William Herbert Hunt and Nelson Bunker Hunt that they have no influence or no voice in Placid Oil Company which is the recipient of the tremendously large loan which was apparently negotiated in part by the U.S. Government; the same U.S. Government which the Hunts continually voice complaints about for interference in business.

Placid Oil is controlled by Nelson Bunker Hunt and William Herbert Hunt at any time they want to control it. They control this corporation as they do other Hunt corporations and trusts and individual accounts as if it were their own private company.

Ms. **Timmer**. You are aware that this statement will become part of the public record?

Mr. **Bledsoe**. Yes.

Ms. **Timmer**. I don't know if you are also aware but there is a Federal law which makes it a criminal act to interfere with any congressional investigation and any witness involved in a congressional investigation.

Have you experienced or do you anticipate experiencing any problems as a result of your giving this information to Congress?

Mr. **Bledsoe**. I have experienced harassment from the Hunts and threats not necessarily on my dealings with Congress but on other business matters, and I expect I shall continue to receive such harassments and threats.

Ms. **Timmer**. You should feel free to let this committee know if as a result of your testimony today any threats or intimidation come to you from any other interested parties, and certainly we will take any steps or measures we can to indicate that your testimony was not only necessary and valuable but part of this subcommittee's particular investigation into recent events in the silver markets.

Thank you for your cooperation.

[Whereupon, at 12 o'clock noon, the business meeting was adjourned.]

F. HUNT ENTITIES LIST, DATED JULY 31, 1978

Hunt Entities List
Revised to 7/31/78

CORPORATIONS

HUNT ENERGY CORPORATION (A Delaware Corporation)	N. B. Hunt	Chairman of the Board & Director
	W. H. Hunt	President & Director
	Lamar Hunt	Vice President & Director
	Margaret Hunt Hill	Director
	Caroline Hunt Schoellkopf	Director
	Tom Hunt	Vice President and Secretary
	J. A. Goodson	Vice President and Treasurer
	Thomas E. Whitaker	Vice President - Administration
	Bill L. Bledsoe	Vice President - Land
	C. H. Mercer	Assistant Treasurer
	Julia Sheerin	Assistant Secretary
	Paul A. Hope	Controller
	Otis Cox	Accountant
HUNT PETROLEUM CORPORATION (A Delaware Corporation)	Tom Hunt	President & Director
	W. H. Hunt	Vice President & Director
	J. A. Goodson	Vice President and Asst. Treasurer
	A. G. Hill	Secretary-Treasurer & Director
	Paul A. Hope	Assistant Secretary
	Stephen H. Sands	Assistant Secretary
	C. H. Mercer	Assistant Treasurer
	Ken Vitosh	Accountant
MASSIE HUNT, INCORPORATED (A Delaware Corporation)	J. A. Goodson	President & Director
	Margaret Hunt Hill	Vice President & Director
	Caroline Hunt Schoellkopf	Director
	Lamar Hunt	Vice President
	A. G. Hill	Secretary
	Paul A. Hope	Assistant Secretary
	C. H. Mercer	Treasurer
	E. Ray McKinney	Assistant Treasurer
	Tom Duvall	Accountant
MASSIE HUNT EXPLORATION COMPANY (A Delaware Corporation)	James L. Parker	President & Director
	Margaret Hunt Hill	Vice President & Director
	J. A. Goodson	Director
	Paul A. Hope	Vice President
	A. G. Hill	Secretary
	Julia Sheerin	Assistant Secretary
	C. H. Mercer	Treasurer
	E. Ray McKinney	Assistant Treasurer
	Tom Duvall	Accountant
PLACID OIL COMPANY (A Delaware Corporation)	C. D. Brown	President & Director
	Margaret Hunt Hill	Vice President & Director
	Lamar Hunt	Vice President & Director
	Walter Fraker	Vice President and Treasurer & Director
	F. G. Clarke	Vice President & Director
	A. F. Nickelson	Vice President
	Paul W. Hicks	Secretary
	R. M. Weddle	Assistant Secretary
	W. P. Denny	Assistant Treasurer
	Ben Cambron	Controller
	Jeff Jones	Accountant
PROSPER ENERGY CORPORATION (A Delaware Corporation)	Lamar Hunt	President
	N. B. Hunt	Vice President
	W. H. Hunt	Director
	David K. Sands	Vice President & Director
	Al G. Hill, Jr.	Director
	Tom Hunt	Vice President
	James L. Parker	Vice President & Director
	C. H. Mercer	Secretary-Treasurer
	J. A. Goodson	Assistant Secretary-Treasurer & Director
	Harold Hackler	Accountant

SUMMIT DEVELOPMENT COMPANY (A Texas Corporation)	Stephen H. Sands	President & Director
	D. H. Hunt	Vice President & Director
	Paul A. Hope	Secretary & Assistant Treasurer & Director
	C. H. Mercer	Treasurer and Assistant Secretary
	Bob Dubberly	Accountant
SEVEN FALLS COMPANY (A Delaware Corporation)	A. G. Hill	Chairman of the Board & Director
	Al G. Hill, Jr.	Vice-Chairman and Chief Executive Officer & Director
	Lyda Hill	President & Director
	Margaret Hunt Hill	Vice President & Director
	Alinda H. Wisenbaker	Vice President & Director
	Ted Burger	Vice President
	Jack M. Lambert	Secretary
	Robert W. Brown	Assistant Secretary
	Jack M. Lambert	Treasurer
	Floyd Nix	Accountant
HILL DEVELOPMENT CORPORATION (A Delaware Corporation)	Lyda Hill	President & Director
	Ted Burger	Vice President
	Alinda H. Wisenbaker	Vice President & Director
	Albert G. Hill, Jr.	Vice President & Director
	Jack M. Lambert	Secretary-Treasurer
	Robert W. Brown	Assistant Secretary
	Mike Cockrell	Accountant
THE GARDEN OF THE GODS CLUB (A Colorado Corporation)	William M. Fuller	President & Director
	James E. Stokes	Vice President & Director
	Lee Higgins	Secretary & Director
	J. Douglas Crouch	Director
	Eugene T. McCleary	Director
	A. G. Hill	Treasurer & Director
	Pet Smith	Accountant
HILL WORLD TRAVEL, INC. (A Texas Corporation)	Harry Branham	President & Director
	Alinda H. Wisenbaker	Vice President & Director
	Lyda Hill	Secretary and Treasurer & Director
	Virginia Dunlop	Accountant
PARK PIPE LINE COMPANY	W. H. Hunt	President & Director
	Margaret Hunt Hill	Director
	Caroline Hunt Schoellkopf	Director
	N. B. Hunt	Vice President
	J. A. Goodson	Secretary-Treasurer
	C. H. Mercer	Assistant Secretary-Treasurer
	Don Sellner	Accountant
PALOMA PIPE LINE COMPANY (A Delaware Corporation)	Walter Fraker	President
	Philip Sowards	Vice President and Secretary
	W. P. Denny	Treasurer and Assistant Secretary
	Larry Williams	Accountant
HUNT ELECTRONICS COMPANY (A Texas Corporation)	N. B. Hunt	Chairman of the Board & Director
	John J. Finegan, Jr.	President
	W. H. Hunt	Vice President & Director
	Lamar Hunt	Vice President & Director
	J. A. Goodson	Secretary-Assistant Treasurer
	C. H. Mercer	Treasurer-Assistant Secretary
	Don Lambert	Accountant
HUNT INTERNATIONAL PETROLEUM CORPORATION (A Delaware Corporation)	C. H. Mercer	President & Director
	Paul A. Hope	Vice President & Director
	J. A. Goodson	Secretary-Treasurer & Director
	Julie Sheerin	Assistant Secretary
	Bill Reed	Accountant

HUNT INTERNATIONAL PETROLEUM COMPANY (NORWAY) (A Delaware Corporation)	N. B. Hunt	President & Director
	W. H. Hunt	Vice President & Director
	J. A. Goodson	Secretary-Treasurer & Director
	Bill Reed	Accountant
HUNT INTERNATIONAL PETROLEUM COMPANY (UNITED KINGDOM) (A Delaware Corporation)	N. B. Hunt	President & Director
	W. H. Hunt	Vice President & Director
	J. A. Goodson	Secretary-Treasurer & Director
	C. H. Mercer	Assistant Secretary-Treasurer
	Bill Reed	Accountant
HUNT INTERNATIONAL PETROLEUM (G.B.) LIMITED (A UK Corporation)	Nelson Bunker Hunt	Chairman of the Board of Directors
	Jean Hain	Secretary
	William Herbert Hunt	Director
	John Alvin Goodson	Director
	Bill Reed	Accountant
PENROD DRILLING SERVICE COMPANY (A Delaware Corporation)	Lamar Hunt	President & Director
	N. B. Hunt	Director
	W. H. Hunt	Director
	Paul A. Hope	Vice President
	J. A. Goodson	Secretary-Treasurer
	B. D. Spurgeon	Assistant Secretary-Treasurer
	Bill Spurgeon	Accountant
PENROD INTERNATIONAL DRILLING COMPANY (A Delaware Corporation)	W. H. Hunt	President
	J. C. Craft	Vice President
	J. A. Goodson	Secretary-Treasurer
	B. D. Spurgeon	Assistant Secretary-Treasurer
	A. G. Hill	Director
	Stephen H. Sands	Director
	James L. Parker	Director
	Bill Spurgeon	Accountant
PENROD MARINE COMPANY (A Delaware Corporation)	J. A. Goodson	President & Director
	Paul A. Hope	Vice President & Director
	C. H. Mercer	Secretary-Treasurer & Director
	Julie Sheerin	Assistant Secretary
	Bill Spurgeon	Accountant
DEL MAR LAND, INC. (An Alaska Corporation)	Bill L. Bledsoe	President & Director
	J. A. Goodson	Vice President & Director
	C. H. Mercer	Secretary-Treasurer & Director
	Bill Reed	Accountant
JUNO UTILITIES, INC. (A Florida Corporation)	N. B. Hunt	President & Director
	J. A. Goodson	Vice President & Director
	C. H. Mercer	Secretary-Treasurer & Director
	Bill Reed	Accountant
KANSAS CITY CHIEFS FOOTBALL CLUB, INC. (A Texas Corporation)	Lamar Hunt	Chairman of the Board
	J. W. Steadman	President
	James H. Schaff	Vice President and General Manager
	James T. Seigfreid	Secretary
	Ronald P. Combest	Treasurer
	William J. Adams	Assistant Secretary
	J. A. Goodson	Assistant Treasurer
	Ronald P. Combest	Accountant
DALLAS TORNADO SOCCER CLUB, INC. (A Delaware Corporation)	L. William McNutt, Jr.	President
	Lamar Hunt	Vice President
	Wayne Henry	Secretary and Assistant Treasurer
	C. H. Mercer	Treasurer and Assistant Secretary
	Wayne Henry	Accountant

WORLD CHAMPIONSHIP TENNIS, INC. (A Delaware Corporation)	Al G. Hill, Jr.	President & Director
	Lamar Hunt	Vice President & Director
	Michael Davies	Vice President and Executive Director
	Frank R. Sitton	Secretary and Treasurer & Director
	A. G. Hill	Assistant Secretary-Treasurer
	Frank R. Sitton	Accountant
WCT, INC. (A Delaware Corporation)	Al G. Hill, Jr.	President & Director
	Lamar Hunt	Vice President & Director
	Michael Davies	Vice President and Executive Director
	Frank R. Sitton	Secretary and Treasurer & Director
	A. G. Hill	Assistant Secretary-Treasurer
	Frank R. Sitton	Accountant
WCT ACADEMIES, INC. (A Delaware Corporation)	Al G. Hill, Jr.	President & Director
	Lamar Hunt	Vice President & Director
	Michael Davies	Vice President and Executive Director
	Frank R. Sitton	Secretary and Treasurer & Director
	A. G. Hill	Assistant Secretary-Treasurer
	Frank R. Sitton	Accountant
MID-AMERICA ENTERPRISES, INC. (A Delaware Corporation)	Lamar Hunt	Chairman of the Board and Vice President
	Jack Steadman	President
	James T. Seigfried	Vice President and Secretary
	Ronald P. Combest	Treasurer
	John A. Goodson	Assistant Secretary and Assistant Treasurer
GREAT MIDWEST CORPORATION (A Delaware Corporation)	Forrest R. Browne	President and Treasurer
	James E. Burke	Vice President and Secretary
	William B. Ernzen	Vice President
	Norman Vitt	Vice President
	Warren P. Muncie	Vice President
	Cherie White	Assistant Secretary
THE ROSEWOOD CORPORATION (A Delaware Corporation)	J. B. Sands	President & Director
	Stephen H. Sands	Vice President & Director
	David K. Sands	Vice President & Director
	J. A. Goodson	Secretary-Treasurer & Director
	Ralph B. Shank	Director
	C. R. Mercer	Assistant Secretary-Treasurer
	Bob Dubberly	Accountant
HUNT MINERALS INTERNATIONAL LIMITED (A Delaware Corporation)	Nelson Bunker Hunt	President & Director
	W. H. Hunt	Vice President & Director
	John A. Goodson	Secretary-Treasurer & Director
	C. R. Mercer	Assistant Secretary-Treasurer
	Don Sellner	Accountant
HUNT HOLDINGS, INC. (A Delaware Corporation)	D. H. Hunt	President & Director
	Barbara Hunt Crow	Vice President & Director
	Tom Hunt	Secretary & Director
	J. A. Goodson	Treasurer and Assistant Secretary
	C. R. Mercer	Assistant Treasurer
	Don Sellner	Accountant
HUNT PROPERTIES, INC. (A Texas Corporation)	William L. Kemp	President
	Len DiGiacomo	Vice President/Sales and Marketing
	Gene Henninger	Vice President/Residential Marketing
	Cecil Kirksey	Vice President/Property Management
	Eric Melgren	Vice President/Treasurer
	Cliff Murphy	Vice President/Design and Build
	Donald E. Young	Vice President/General Counsel and Secretary
	Beverley Gore	Assistant Secretary
	Stephen H. Sands	Director
	D. H. Hunt	Director
	Paul A. Hope	Director

PLACER PROPERTIES, INC. (A Delaware Corporation)	A. P. Stephens	President & Director
	W. H. Hunt	Vice President and Assistant Secretary-Treasurer & Director
	Leslie R. Bonner	Secretary-Treasurer & Director
PATRON PROPERTIES, INC. (A Delaware Corporation)	A. P. Stephens	President & Director
	W. H. Hunt	Vice President and Assistant Secretary-Treasurer & Director
	Leslie R. Bonner	Secretary-Treasurer & Director
YUCCA BUTTE CORPORATION (A Texas Corporation)	Houston Bunker Hunt	President & Director
	Bill L. Bledsoe	Vice President & Director
	James L. Parker	Secretary-Treasurer & Director
	Ellen Hunt Flowers	Assistant Secretary-Treasurer & Director
	Elizabeth Hunt Curnes	Director
	Mary Hunt Huddleston	Director
	Bill Reed	Accountant
HUNT SERVICES, INC. (A Texas Corporation)	William L. Hamm	President
	Eric Melgren	Vice President/Treasurer
	Donald K. Young	Secretary
	Beverley Gore	Assistant Secretary
	Stephen H. Sands	Director
	D. H. Hunt	Director
	Paul A. Hope	Director
SHEEP MOUNTAIN LAND COMPANY (A Montana Corporation)	Bill L. Bledsoe	President & Director
	C. H. Mercer	Vice President & Director
	J. A. Goodson	Secretary-Treasurer & Director
PURSUE ENERGY CORPORATION (A Delaware Corporation)	Bill L. Bledsoe	President & Director
	H. Wayne Gifford	Vice President & Director
	William G. Reed	Secretary-Treasurer & Director
	Rosenell Duff	Assistant Secretary
PURSUE PETROCHEMICAL CORPORATION (A Delaware Corporation)	Bill L. Bledsoe	President & Director
	H. Wayne Gifford	Vice President & Director
	William G. Reed	Secretary-Treasurer & Director
	Rosenell Duff	Assistant Secretary

PARTNERSHIPS

PENROD DRILLING COMPANY	William Herbert Hunt Trust Estate	Partner
	Lamar Hunt Trust Estate	Partner
	Nelson Bunker Hunt Trust Estate	Partner
	W. H. Hunt	General Manager
	J. C. Craft	General Superintendent
	F. K. Newlin	Authorized Agent
	Bill Spurgeon	Accountant
HUNT INDUSTRIES	Lyda Hunt-Margaret Trusts	Partner
	Lyda Hunt-Caroline Trusts	Partner
	Lyda Hunt-Bunker Trusts	Partner
	Lyda Hunt-Herbert Trusts	Partner
	Lyda Hunt-Lamar Trusts	Partner
	Harold Hackler	Accountant
PROPEL ENERGY COMPANY	Lyda Hunt-Bunker Trusts	Partner
	Lyda Hunt-Herbert Trusts	Partner
	Lyda Hunt-Lamar Trusts	Partner
	Harold Hackler	Accountant

RANKIN ENERGY COMPANY	Lyda Hunt-Bunker Trusts	Partner
	Lyda Hunt-Herbert Trusts	Partner
	Lyda Hunt-Lamar Trusts	Partner
	Lyda Hunt-Margaret Trusts	Partner
	Harold Hackler	Accountant
HUNT INTERNATIONAL PETROLEUM COMPANY	N. B. Hunt	Executive Manager (Partner)
	W. H. Hunt	Manager of Exploration (Partner)
	Lamar Hunt	Coordinating Manager (Partner)
	Bill Reed	Accountant
HUNT INTERNATIONAL PETROLEUM COMPANY OF CANADA	N. B. Hunt	Partner
	W. H. Hunt	Partner
	Lamar Hunt	Partner
	Bill Reed	Accountant
HUNT INTÊRNATIONAL PETROLEUM COMPANY OF NEW ZEALAND	N. B. Hunt	Partner
	W. H. Hunt	Partner
	Lamar Hunt	Partner
	Bill Reed	Accountant
PLANET PETROLEUM COMPANY	W. H. Hunt	Partner
	N. B. Hunt	Partner
	Lamar Hunt	Partner
	Don Sellner	Accountant
HOLIDAY MILLS	W. H. Hunt	Partner
	N. B. Hunt	Partner
	Lamar Hunt	Partner
	Don Sellner	Accountant
DALLAS BOWLING CENTER	W. H. Hunt	Partner
	N. B. Hunt	Partner
	Lamar Hunt	Partner
	Wayne Henry	Accountant
PETROMAR SERVICOS MARITIMOS, LTD. (A Partnership)	Lamar Hunt	Partner
	W. H. Hunt	Partner
	N. B. Hunt	Partner
	Bill Spurgeon	Accountant
PRIMAL BOAT COMPANY (A Partnership)	Primal Trust No. 1	Partner
	Primal Trust No. 2	Partner
	Primal Trust No. 3	Partner
	Primal Trust No. 4	Partner
	Primal Trust No. 5	Partner
	Primal Trust No. 6	Partner
	Paul A. Hope	Manager
	Bill Spurgeon	Accountant
THE PARADE COMPANY	Placid Oil Company	Partner
	D. P. Hamilton	Partner
	Gladstone Gasoline Company, Inc.	Partner
	Mrs. George J. Westbrook	Partner
	Ralph Worley	General Manager
PORTAL BOAT COMPANY (A Partnership)	Primal Trusts	Partner
	Primal Trust No. 7	Partner
	Paul A. Hope	Manager
	Bill Spurgeon	Accountant

GLENCOE APARTMENTS (Promenade)	W. H. Hunt	Partner
	Paul Stephens	Partner
	Stan Jeffress	Accountant
WESTWOOD SHOPPING CENTER	W. H. Hunt	Partner
	Paul Stephens	Partner
	Stan Jeffress	Accountant
THE 4219 SIGMA PARTNERSHIP OF TEXAS	Wilson Loyd Sands Trust A	Partner
	Lowell Hunt Sands Trust A	Partner
	Stephen Storm Sands Trust A	Partner
	John Bowmer Sands Trust A	Partner
	Haven Starbuck Sands Trust A	Partner
	David Sands Trust	Partner
	Laurie Sands Trust	Partner
	Stephen H. Sands, Trustee	Partner
	Bob Dubberly	Accountant

LIMITED PARTNERSHIP

LAKEWAY WORLD OF TENNIS	World Championship Tennis, Inc.	General Partner
	Alpert Investment Corp.	Limited Partner
	Ivan Irwin, Jr.	Limited Partner
	Frank Sitton	Accountant
PEACHTREE WORLD OF TENNIS	World Championship Tennis, Inc.	General Partner
	Ivan Irwin, Jr.	Limited Partner
	Frank Sitton	Accountant

JOINT VENTURES

IRWIN-HILL TRUST VENTURE	Ivan Irwin, Jr.	Joint Venturer
	Albert Hill Trust	Joint Venturer
	Mike Cockrell	Accountant

TRUSTS

CONSOLIDATED PENSION TRUST	W. H. Hunt	Trustee
	Walter Fraker	Trustee
	Bill Spurgeon	Trustee
	J. A. Goodson	Retirement Committee Member
	B. H. Cambron	Retirement Committee Member
	Robert E. Thomas	Retirement Committee Member
	Louise Kalb	Accountant
CONSOLIDATED THRIFT TRUST	J. A. Goodson	Trustee
	Walter Fraker	Trustee
	Bill Spurgeon	Trustee
	Louise Kalb	Accountant

Thrift Plan Administrative Committee: J. A. Goodson
Robert M. Adkins
Bill Spurgeon
Thomas E. Whitaker
B. H. Cambron
Robert E. Thomas

HASSIE HUNT TRUST	Margaret Hunt Hill	Trustee
	Caroline Hunt Schoellkopf	Member of Advisory Board
	J. A. Goodson	Member of Advisory Board
	Tom Duvall	Accountant
MARGARET HUNT TRUST ESTATE	Tom Hunt	Trustee
	Caroline Hunt Schoellkopf	Member of Advisory Board
	Lamar Hunt	Member of Advisory Board
	Floyd Nix	Accountant
HAROLDSON L. HUNT, JR. TRUST ESTATE	A. G. Hill	Trustee
	Lamar Hunt	Member of Advisory Board
	W. H. Hunt	Member of Advisory Board
	Tom Duvall	Accountant
CAROLINE HUNT TRUST ESTATE	J. A. Goodson	Trustee
	Margaret Hunt Hill	Member of Advisory Board
	Tom Hunt	Member of Advisory Board
	Bob Dubberly	Accountant
NELSON BUNKER HUNT TRUST ESTATE	James L. Parker	Trustee
	A. G. Hill	Member of Advisory Board
	J. A. Goodson	Member of Advisory Board
	Bill Reed	Accountant
WILLIAM HERBERT HUNT TRUST ESTATE	Stephen H. Sands	Trustee
	Margaret Hunt Hill	Member of Advisory Board
	Paul A. Hope	Member of Advisory Board
	Don Sellner	Accountant
LAMAR HUNT TRUST ESTATE	A. G. Hill	Trustee
	Caroline Hunt Schoellkopf	Member of Advisory Board
	Wm. J. Adams	Member of Advisory Board
	Wayne Henry	Accountant
PRIMAL TRUSTS	Stuart Hunt	Trustee
	Walter Fraker	Member of Advisory Board
	Ivan Irwin, Jr.	Member of Advisory Board
	Don Sellner	Accountant
PRIMAL TRUST NO. 7	Stuart Hunt	Trustee
	Walter Fraker	Member of Advisory Board
	Ivan Irwin, Jr.	Member of Advisory Board
	Don Sellner	Accountant
LYDA HUNT-MARGARET TRUSTS (effective 8/16/78)	Margaret Hunt Hill	Trustee
	Stephen H. Sands	Trustee
	J. A. Goodson	Trustee
	Mike Cockrell	Accountant
LYDA HUNT-CAROLINE TRUSTS	Caroline Hunt Schoellkopf	Trustee
	J. A. Goodson	Trustee
	Don W. Crisp	Trustee
	Bob Dubberly	Accountant
LYDA HUNT-BUNKER TRUSTS	Margaret Hunt Hill	Trustee
	Caroline Hunt Schoellkopf	Trustee
	W. H. Hunt	Trustee
	Harold Hackler	Accountant
LYDA HUNT-HERBERT TRUSTS	Margaret Hunt Hill	Trustee
	Caroline Hunt Schoellkopf	Trustee
	W. H. Hunt	Trustee
	Harold Hackler	Accountant

LYDA HUNT-LAMAR TRUSTS	Margaret Hunt Hill	Trustee
	Caroline Hunt Schoellkopf	Trustee
	W. H. Hunt	Trustee
	Harold Hackler	Accountant
LYDA HILL TRUST ESTATE	Al G. Hill, Jr.	Trustee
	Caroline Hunt Schoellkopf	Member of Advisory Board
	Margaret Hunt Hill	Member of Advisory Board
	Mike Cockrell	Accountant
ALBERT HILL TRUST	Lyda Hill	Trustee
	Caroline Hunt Schoellkopf	Member of Advisory Board
	Margaret Hunt Hill	Member of Advisory Board
	Alinda Hill Wisenbaker	Member of Advisory Board
	Mike Cockrell	Accountant
ALINDA HUNT HILL TRUST	Lyda Hill	Trustee
	Margaret Hunt Hill	Member of Advisory Board
	Jack Lambert	Member of Advisory Board
	Mike Cockrell	Accountant
HILL III TRUST	Margaret Hunt Hill	Trustee
	Alinda Hunt Hill	Member of Advisory Board
	Dorothy Van Ness	Member of Advisory Board
	Mike Cockrell	Accountant
THE HEATHER HILL TRUST	A. G. Hill	Trustee
	Lyda Hill	Member of Advisory Board
	Fred Vinson	Member of Advisory Board
	Mike Cockrell	Accountant
ELISA MARGARET HILL TRUST	Lyda Hill	Trustee
	A. G. Hill	Member of Advisory Board
	Margaret Hunt Hill	Member of Advisory Board
	Mike Cockrell	Accountant
MICHAEL BUSH WISENBAKER, JR. TRUST	Margaret Hunt Hill	Trustee
	A. G. Hill	Member of Advisory Board
	Lyda Hunt Hill	Member of Advisory Board
	Mike Cockrell	Accountant
STEPHEN SANDS TRUST	Caroline Hunt Schoellkopf	Trustee
	Edwin L. Cox	Member of Advisory Board
	Loyd B. Sands	Member of Advisory Board
	Bob Dubberly	Accountant
BUNKER SANDS TRUST	Caroline Hunt Schoellkopf	Trustee
	Edwin L. Cox	Member of Advisory Board
	Loyd B. Sands	Member of Advisory Board
	Bob Dubberly	Accountant
DAVID SANDS TRUST	Tom Hunt	Trustee
	James M. Collins	Member of Advisory Board
	Loyd B. Sands	Member of Advisory Board
	Bob Dubberly	Accountant
LAURIE SANDS TRUST	Don W. Crisp	Trustee
	Stephen H. Sands	Member of Advisory Board
	J. B. Sands	Member of Advisory Board
	David K. Sands	Member of Advisory Board
	Bob Dubberly	Accountant

PATRICK SANDS TRUST A	Tom Hunt	Trustee
	Loyd B. Sands	Member of Advisory Board
	J. A. Goodson	Member of Advisory Board
	Bob Dubberly	Accountant
WILSON LOYD SANDS TRUST A	J. B. Sands	Trustee
	Stephen Hunt Sands	Member of Advisory Board
	Caroline Hunt Schoellkopf	Member of Advisory Board
	Bob Dubberly	Accountant
LOWELL HUNT SANDS TRUST A	J. B. Sands	Trustee
	Stephen Hunt Sands	Member of Advisory Board
	Caroline Hunt Schoellkopf	Member of Advisory Board
	Bob Dubberly	Accountant
STEPHEN STORM SANDS TRUST A	J. B. Sands	Trustee
	Stephen Hunt Sands	Member of Advisory Board
	Caroline Hunt Schoellkopf	Member of Advisory Board
	Bob Dubberly	Accountant
JOHN BOWMER SANDS TRUST A	J. B. Sands	Trustee
	Stephen Hunt Sands	Member of Advisory Board
	Caroline Hunt Schoellkopf	Member of Advisory Board
	Bob Dubberly	Accountant
HAVEN STARBUCK SANDS TRUST A	Stephen H. Sands	Trustee
	J. B. Sands	Member of Advisory Board
	Caroline Hunt Schoellkopf	Member of Advisory Board
	Bob Dubberly	Accountant
HOUSTON HUNT TRUST A	Caroline Hunt Schoellkopf	Trustee
	Caroline Hunt	Member of Advisory Board
	W. H. Hunt	Member of Advisory Board
	Bill Reed	Accountant
JAMES HUNT FLOWERS TRUST A	Lamar Hunt	Trustee
	W. H. Hunt	Member of Advisory Board
	Caroline Hunt Schoellkopf	Member of Advisory Board
	Bill Reed	Accountant
ERIKA GORDON HUDDLESTON TRUST A	W. H. Hunt	Trustee
	Lamar Hunt	Member of Advisory Board
	Caroline Hunt Schoellkopf	Member of Advisory Board
	Bill Reed	Accountant
BRUCE HUNT TRUST A	Tom Hunt	Trustee
	Nancy B. Hunt	Member of Advisory Board
	Lamar Hunt	Member of Advisory Board
	Don Sellner	Accountant
DAVID SHELTON HUNT TRUST A	Tom Hunt	Trustee
	Nancy B. Hunt	Member of Advisory Board
	Lamar Hunt	Member of Advisory Board
	Don Sellner	Accountant
SHARRON HUNT TRUST A	Caroline Hunt Schoellkopf	Trustee
	Margaret Hunt Hill	Member of Advisory Board
	Loyd B. Sands	Member of Advisory Board
	Wayne Henry	Accountant

CLARK HUNT TRUST A	Caroline Hunt Schoellkopf Margaret Hunt Hill Loyd B. Sands Wayne Henry	Trustee Member of Advisory Board Member of Advisory Board Accountant
DANIEL LIND HUNT TRUST A	Caroline Hunt Schoellkopf Margaret Hunt Hill Loyd B. Sands Wayne Henry	Trustee Member of Advisory Board Member of Advisory Board Accountant

INDIVIDUALS

A. G. HILL (Margaret Hunt Hill)	Floyd Nix	Accountant
CAROLINE HUNT SCHOELLKOPF (Hugo W. Schoellkopf, Jr.)	Bob Dubberly	Accountant
LOYD B. SANDS (Jackie C. Sands)	Bob Dubberly	Accountant
N. B. HUNT (Caroline L. Hunt)	Bill Reed	Accountant
W. H. HUNT (Nancy Broaddus Hunt)	Don Sellner	Accountant
W. H. HUNT, Special	Dan Sellner	Accountant
LAMAR HUNT (Norma K. Hunt)	Wayne Henry	Accountant
LYDA HILL	Mike Cockrell	Accountant
ALBERT G. HILL, JR. (Vicki V. Hill)	Mike Cockrell	Accountant
ALINDA H. WISENBAKER (Michael B. Wisenbaker)		
STEPHEN HUNT SANDS (Marcellene Wilson Sands)	Bob Dubberly	Accountant
JOHN BUNKER SANDS (Ramona Stark Sands)	Bob Dubberly	Accountant
DAVID SANDS (Nancy G. Sands)	Bob Dubberly	Accountant
LAURIE SANDS	Bob Dubberly	Accountant

D. H. HUNT (Margaret F. Hunt)	Don Sellner	Accountant
BARBARA HUNT CROW (Trammell Crow, Jr.)	Don Sellner	Accountant
BRUCE WILLIAM HUNT	Don Sellner	Accountant
LYDA HUNT BROWN (Stephen Smiley Brown)	Don Sellner	Accountant
ELLEN HUNT FLOWERS (Paul William Flowers)	Bill Reed	Accountant
MARY HUNT HUDDLESTON (Albert D. Huddleston)	Bill Reed	Accountant
ELIZABETH HUNT CURNES (Thomas J. Curnes)	Bill Reed	Accountant
HOUSTON BUNKER HUNT	Bill Reed	Accountant
LAMAR HUNT, JR.	Wayne Henry	Accountant
SHARRON LYNNE HUNT	Wayne Henry	Accountant

MINORS AND/OR CUSTODIAN ACCOUNTS

DAVID SHELTON HUNT	Don Sellner	Accountant
PATRICK SANDS	Bob Dubberly	Accountant
CLARK HUNT	Wayne Henry	Accountant
DANIEL LINN HUNT	Wayne Henry	Accountant
ALBERT G. HILL, III	Mike Cockrell	Accountant
HEATHER HILL	Mike Cockrell	Accountant
ELISA MARGARET HILL	Mike Cockrell	Accountant
MICHAEL BUSH WISENBAKER, JR.		
WESLEY HILL WISENBAKER		
WILSON LOYD SANDS	Bob Dubberly	Accountant
LOWELL HUNT SANDS	Bob Dubberly	Accountant
STEPHEN STORM SANDS	Bob Dubberly	Accountant

JOHN BONNER SANDS	Bob Dubberly	Accountant
HAVEN STARBUCK SANDS	Bob Dubberly	Accountant

TRADE NAMES

TEXAS HONEY COMPANY	David K. Sands Bob Dubberly	 Accountant

FOUNDATIONS

THE SANDS FOUNDATION	Loyd B. Sands W. H. Hunt Caroline Hunt Schoellkopf	President Vice President Managing Trustee and Secretary-Treasurer
HILL FOUNDATION	A. G. Hill Margaret Hunt Hill Jack Lambert	President and Chairman of the Board Vice President Secretary-Treasurer
NINE STAR FOUNDATION	Wayne Henry Jean Finn Lamar Hunt	President Vice President Managing Trustee and Secretary-Treasurer
HASSIE HUNT FOUNDATION, INC.	Lamar Hunt J. A. Goodson Margaret Hunt Hill	President Vice President Secretary-Treasurer

G. NELSON BUNKER HUNT TRUST ESTATE, ANALYSIS OF INVESTMENTS AND FIXED ASSETS ON SEPTEMBER 30, 1973

NELSON BUNKER HUNT TRUST ESTATE
ANALYSIS OF INVESTMENTS AND FIXED ASSETS
AT SEPTEMBER 30, 1973

	INVESTMENT	PURCHASE MONEY OBLIGATION
STOCKS AND BONDS		
Alaska State Bank 3,060 Shares	$ 128,186	
Communications Satellite Corp. 1,500 Shares	90,213	
Desert Pharmaceutical 2,500 Shares	51,831	
Farmers New World Life Ins. Co. 2,500 Shares	46,781	
First National City Bank 9 1/8% $100,000 CD due 10-10-73	100,000	
First National City Bank 9 3/4% $150,000 CD due 12-26-73	150,015	
Hunt Oil Company 2,999.94 Shares	60,000	
Hunt Petroleum Corporation 120 Shares	12,000	
International Business Machines 100 Shares	28,500	
International Telephone and Telegraph 1,000 Shares	18,132	
[illegible] International Corp. 1,000 Shares	54,571	
Life of Kentucky Financial Corp. 14,020 Shares	-	
Lonrho Ltd. AR's 20,000 Shares	66,280	
Monsanto Company 1,000 Shares	54,746	
Patagenia Corp. 3,500 Shares	77,374	
Placid Oil Company 620 5/6 Shares	103,750	
Summit Development Company 500 Shares	89,000	
Tokio Marine & Fire Insurance, Ltd. - ADR 225 Shares	54,427	
	$ 1,185,806	
PARTNERSHIPS		
Penrod Drilling Company	$ 4,909,533	
WORK IN PROGRESS		
Geological & Geophysical Expense	$ 69,462	
GAS SYSTEMS		
Lucky	$ 20,302	

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NELSON BUNKER HUNT TRUST ESTATE
ANALYSIS OF INVESTMENTS AND FIXED ASSETS
AT SEPTEMBER 30, 1973

	INVESTMENT	PURCHASE MONEY OBLIGATION
CYCLING UNITS		
Brookhaven	$ 77,997	
UNDEVELOPED LEASES		
Alaska	$ 4,221	
UNDEVELOPED ROYALTIES		
Texas	$ 29,310	
South Dakota	3,227	
	$ 32,537	
UNDEVELOPED COAL LEASES		
North Dakota	$ 221,753	
REAL ESTATE		
Held for Development or Investment San Bernardino County, California		
255 60 acre Century Boulevard Corporation Tract, out of the SBB&M Survey - Full Interest	$ 423,909	$ 20,000
Farming and Ranching Mendocino County, California		
452 14,584 acres, Starlight Ranch - Full Interest	2,750,000	2,000,000
Farming Riverside County, California		
466 592 acres, Lake Mathews Quadrangle - Full Interest	1,300,718	1,000,000
467 1,500 acres, Lake Mathews Quadrangle - Full Interest	975,549	690,000

NELSON BUNKER HUNT TRUST ESTATE
ANALYSIS OF INVESTMENTS AND FIXED ASSETS
AT SEPTEMBER 30, 1973

		INVESTMENT	PURCHASE MONEY OBLIGATION
	REAL ESTATE Cont'd.		
	Farming and Ranching		
	Collin County, Texas		
253	135.12 acre M. F. Blaine Tract out of William Culwell Survey, Abstract 177 and W. P. Allen Survey, Abstract 11, on waters of Little Elm Creek - Full Interest	$ 41,727	$ 8,400
420	200 acre Thompson Tract - Full Interest	66,490	27,845
	Collin, Denton and Grayson Counties, Texas		
227	3,300 acre C. D. Wyche Tract out of Herrera Survey, Abstract 545, Garcia Survey, Abstract 446, R. Mason Survey, Abstract 784, Richards Survey, Abstract 938, Baker Survey, Abstract 1256, C. Mason Survey, Abstract 858, Harmon Survey, Abstract 604, Wells Survey, Abstract 1354, Worrell Survey, Abstract 1357 and J. Curbello Survey, Abstract 217 - Full Interest	917,850	
	Denton and Grayson Counties, Texas		
251	323 acre Robert A. Yarber Tract out of Juan Curbella Survey and A. H. Gee Survey, Abstract 1522 - Full Interest	94,069	25,232
315	2,992.939 acre Erskine College Tract out of William W. Holman Survey, J. P. McDaniel Survey, Newton McMillan Survey, Joseph L. Bennett Survey, Reese Hughes Survey, Elijah Emberson Survey, Henry Tierwester Survey, A. H. Wiley Survey, George M. Dial Survey, Charles Fleisner Survey, F. A. Hammon Survey, Thomas Toby Survey - Full Interest	858,820	86,485
	Denton County, Texas		
292	113 19/20 acre Robert A. Yarber Tract out of Juan Curbella Survey, Abstract 213 - Full Interest	34,913	

		INVESTMENT	PURCHASE MONEY OBLIGATION
REAL ESTATE Cont'd.			
Held for Development or Investment Collin and Dallas Counties, Texas			
325	100.072 acre Will R. Wilson, Jr. Tract out of the John U. Vance Survey, Abstract 942 and Abstract 1513 - 1/2 Interest	$ 300,294	$ 150,216
125	65.507 acre Georginna G. Hasford Tract out of John U. Vance Survey, Abstract 1513 - 1/2 Interest	64,607	
213	233.399 acre Robert B. Webb Tract out of the John U. Vance Survey, Abstract 1513 and Abstract 942 - 1/2 Interest	276,532	
264	9.31 acre Canyon Creek Land Corp. Tract out of R. Copeland Survey, Abstract 1618, City of Richardson, and J. U. Vance Survey, Abstract 942 - 1/2 Interest	35,071	
Dallas County, Texas			
321	152.30 acre Lone Star Company Tract out of the A. T. Hanny Survey, Abstract 1093 - 1/2 Interest	761,526	
233	130 acre Platter Investment Company Tract out of Elizabeth Lamar (or Larner) Survey, Abstract 797 - Full Interest	200,096	
Farming and Ranching Collin County, Texas			
248	158 acre John M. Gray Tract out of Thomas Stayton Survey, Abstract 803 - Full Interest	55,337	14,467

WELDON BUNKER HUNT TRUST ESTATE
ANALYSIS OF INVESTMENTS AND FIXED ASSETS
AT SEPTEMBER 30, 1973

REAL ESTATE Cont'd.
Farming and Ranching
Denton County, Texas

		INVESTMENT	PURCHASE MONEY OBLIGATION
237	125.711 acre Robert A. Yarber Tract out of Juan Curbello Survey, Abstract 213, A. H. Gee Survey, Abstract 1522 - Full Interest	$ 28,116	

Grayson County, Texas

		INVESTMENT	PURCHASE MONEY OBLIGATION
228	325.30 acre Robert A. Yarber Tract out of Richard Garcia Survey, Abstract 446, Marie Sonora Herrera Survey, Abstract 545, Robert Mason Survey, Abstract 784 - Full Interest	67,037	$ 31,684
229	228.5 acre Robert A. Yarber Tract out of William Richards Survey - Full Interest	69,834	24,000
230	901.38 acre Robert A. Yarber Tract out of Robert Mason Survey, Abstract 784 and Richard Garcia Survey, Abstract 446 - Full Interest	214,283	85,333
232	468.19 acre Robert A. Yarber Tract out of William Richards Survey - Full Interest	112,530	44,943
236	409.0 acre Kenneth D. Dealey Tract being 289.10 acres out of the Charles Kluting Survey and W. H. Trollinger Survey and 120 acres out of the John Aldridge Survey, Abstract 36 and D. Perry Survey, Abstract 966 - Full Interest	100,066	[illegible]3,269
245	20 acre Robert A. Yarber Tract out of William Wells Survey, Abstract 1354 - Full Interest	5,860	
246	122.5 acre Robert A. Yarber Tract out of Thomas Toby Survey, Abstract 1256 and Charles Mason Survey, Abstract 858 - Full Interest	39,004	

NELSON BUNKER HUNT TRUST ESTATE
ANALYSIS OF INVESTMENTS AND FIXED ASSETS
AT SEPTEMBER 30, 1973

			INVESTMENT	PURCHASE MONEY OBLIGATION
		REAL ESTATE Cont'd.		
		Farming and Ranching		
		Grayson County, Texas		
606 ✓	247	205 acre Leola Sunshine Cooper Tract out of John Aitkin Survey, Abstract 11 - Full Interest	$ 46,373	$ 13,890
	384	122.41 acre Elsie Ione Patterson Tract out of Robert Mason Survey, Abstract 784 - Full Interest	37,919	18,987
	395	728 acres in James Cornell Survey A-217 and J. M. Jenneys Survey, Abstract 643 - purchased from Murphy Bounds - Full Interest	314,589	283,000
	408	240.92 acre Jim Martinek Tract - Full Interest	96,764	56,800
		Kaufman County, Texas		
150	212	592.91 acre Wade T. Ingram Tract out of B.B.B. & C.R.R. Co. Survey - Full Interest	172,660	
	239	355.3 acre Robert A. Yarber Tract out of Phillip Walker Survey - Full Interest	60,068	36,514
	262	115.783 acre William R. Williams Tract out of BBB and CRR Co. Survey, Abstract 65 - Full Interest	34,512	
	412	353.207 ac. Corley Tract - Full Interest	118,278	62,712
	445	1,909.506 acres, Lincoln Company Tract - Full Interest	859,295	655,000
	265	115.127 acre Mary P. Griffitts Tract out of the BBB & CRR Co. Survey, Abstract 65 - Full Interest	34,535	
			$11,569,231	$5,348,737

HUNT ENERGY CORPORATION
DRILLING PROGRAM

	1978 %
Hassie Hunt, Incorporated	21
Hassie Hunt Trust	2
Haroldson L. Hunt, Jr. Trust Estate	2
Hunt Petroleum Corporation	20
Hunt Industries	1
Caroline Hunt Trust Estate	18
Nelson Bunker Hunt Trust Estate	12
William Herbert Hunt Trust Estate	9
Lamar Hunt Trust Estate	11
A. G. Hill	3
Hunt Energy Corporation	1

H. RÉSUMÉ OF BILL L. BLEDSOE, APRIL 17, 1980

April 17, 1980

BILL L. BLEDSOE

Presently:

President
Bledsoe Energy Corporation,
a Texas Corporation
Oil and Gas Exploration

President
False River Company
Oil and Gas Exploration

Director
Magnum Oil Corporation
Oil and Gas Exploration - West Virginia

General Partner
Reinhard Energy Ltd.
Oil and Gas Exploration

Former Employment:

1960 - 1965

TEXACO, INC.
Oil Scout, Petroleum Landman in Texas, Arkansas and Louisiana

1965 - 1975

PLACID OIL COMPANY
Assistant Land Manager - experience in Texas, Arkansas, Mississippi, Louisiana, North and South Dakota, Alabama, Florida and Rocky Mountains

1975 - 1979

HUNT ENERGY CORPORATION
Vice President - Land Manager
Supervised 60 employees plus 90 brokers; managed exploration program in domestic United States consisting of $100,000,000 annual expenditures

Other assignments, offices and duties:

NELSON BUNKER HUNT
Personal Assistant and Representative
1973 - 1979

H. L. HUNT (Deceased)
Personal Representative

HUNT INTERNATIONAL PETROLEUM CORPORATION
1975 - 1979
General Manager - International Negotiator for all exploration operations including New Zealand, Canada, Japan, England, Ireland, Scotland, Pakistan, Australia, Africa, France, Iran, Norway and Sweden

SEA HUNT GROUP - NEW ZEALAND
1977 - 1979
Chairman, Operations Committee
Sea Hunt consisted of consortium of Hunt International Petroleum Corporation, Phillips Petroleum, Placid International, Impel Corporation and Petrocorp - New Zealand Government Company; drilled seven offshore exploratory wells in water depths exceeding 2,300' offshore New Zealand at a cost of $75,000,000

NELSON BUNKER HUNT TRUST ESTATE
1975 - 1979
General Manager
Included operations in petroleum, real estate, cattle ranching, thoroughbred horses, and other investments

PURSUE ENERGY CORPORATION
1977 - 1979
President
Included management of $30,000,000 exploration and producing program in Thomasville-Piney Woods Field complex, Rankin County, Mississippi

PURSUE PETROCHEMICAL CORPORATION
1978 - 1979
President
Included management of $60,000,000 financing and construction of petrochemical plant in Mississippi

SCHEUTZOW HELICOPTER CORPORATION
1977 - 1979
Vice President
Research and development operations for experimental helicopter

SHEEP MOUNTAIN LAND COMPANY
1977 - 1979
President
Land and mineral company in Rocky Mountains

DEL MAR CORPORATION
1977 - 1979
President
Land acquisition and development company in Anchorage, Alaska

LITTLE HORN LAND COMPANY
1977 - 1979
President
Ranching entity in Montana

YUCCA BUTTE CORPORATION
1977 - 1979
Vice President
Pipeline company in West Texas

Other Activities in Which Bledsoe Owns an Interest:

Bledsoe Energy Corporation, President

False River Company, a Louisiana Corporation, President

Magnum Oil Corporation, Parkersburg, West Virginia, Director

Hazelgreen Farm, President
Ranching and real estate activities in West Virginia

Bledsoe Land & Cattle Company, Vice President
Ranching and real estate activies in Oklahoma

AZSUA, Inc. an Oklahoma Corporation, President
Oil, gas and minerals

Other exploratory areas which Bledsoe is concentrating include;

Anadarko Basin and Arkhoma Basin - Oklahoma

Overthrust Belt - Idaho, Utah, Wyoming and Montana

Williston Basin - North Dakota, South Dakota and Montana

Rocky Mountains - Colorado and Montana

Cotton Valley Trend - East Texas and North Louisiana

Gray Sand Trend - North Louisiana

Deep Smackover - Mississippi, Alabama and Florida

1979 - 1980 Activity of Bledsoe Energy Corporation in the Tuscaloosa Trend:

In 1979 - 1980 Bledsoe originated or participated in the following Tuscaloosa prospects:

North False River Prospect
Pointe Coupee Parish, Louisiana

Odessa Natural Gas #1 Jewell; new discovery at 19,800'

East False River Prospect
West Baton Rouge Parish, Louisiana

Mid-American Oil & Gas, Inc. - Martin-Bledsoe #1 Belmont Plantaion; drilling to proposed total depth of 23,000'

Moore-Sams Field
Livingston Parish, Louisiana

Chevron Oil Company #1 Deville; proposed total depth of 20,000'

Amoco Oil Company #1 Hurst; discovery well

Amoco Oil Company #1 Butler; confirmation well

Royalty interest only

Prairie Bayou Prospect
Livingston Parish, Louisiana

Mid-American #1 Crown Zellerbach; proposed total depth of 21,500'

Sandy Creek Prospect
Livingston Parish, Louisiana

Mid-American #1 Calmes; proposed total depth of 17,000'

North Watson Prospect
Livingston Parish, Louisiana

Shell Oil Company #1 Caraway; proposed total depth of 17,000'

Appalachian Activity:

Magnum Oil Corporation - drilled and completed six successful shallow wells in the first quarter of 1980. Have option to acquire 167 producing wells with secondary recovery prospects.

References:

Nelson Bunker Hunt
2500 First National Bank Building
Dallas, Texas 75202
(214) 748-1300

M. B. Rudman
Chairman of the Board and President
Rudman Resources, Inc.
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(214) 741-5448

Richard L. Freeman
Shell Oil Company
One Shell Square
New Orleans, Louisiana 70160
(504) 588-7361

Ben T. Morris, Jr., President
Mid-American Oil & Gas, Inc.
3323 Entex Building
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Houston, Texas 77002
(713) 651-1797

Thomas P. Tatham, President
Tatham Corporation
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Vice President
Bass Enterprises Production Company
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(214) 742-2396

Ken Martin, President
Martin Exploration Company
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Metairie, Louisiana 70002
(504) 837-8990

Ben Martin
Chevron USA, Inc.
1111 Tulane Avenue
New Orleans, Louisiana 70112
(504) 521-6763

Dr. C. E. Willingham
Oil and Gas Investments
Post Office Box 6326
Tyler, Texas 75711
(214) 593-2925

Home Address:	9567 Millridge Drive Dallas, Texas 75243 (214) 341-0183
Family:	Married (once) Two children, ages 21 and 17
Business Address:	Bledsoe Energy Corporation 4600 Republic National Bank Tower Dallas, Texas 75201 (214) 742-7021
Education:	North Texas State University Denton, Texas Bachelor of Science Degree Graduated 1957 Southern Methodist University Dallas, Texas 1970 - 1971 - Business Law
Military:	United States Navy 1957 - 1960 3½ years active duty Flight School - Pensacola, Florida Patrol Squadron 2, NAS Whidbey Island, Washington Air Intelligence Officer Completed 20 years service in Naval Reserve Rank: Lt. Commander
Hobbies:	Golf
Organizations:	Dallas Association of Petroleum Landmen, Former President and Director American Association of Petroleum Landmen Dallas Petroleum Club Dallas Athletic Club
Summary:	Bill L. Bledsoe has 20 years experience in the oil, gas and mineral industry, approximately one-fourth of experience with Texaco and three-fourths with the Hunt family interest. Each of these companies is well known for its aggressiveness, expertise, and success in the petroleum industry. Bledsoe has professional petroleum experience in Texas, Louisiana, Utah, Oklahoma, New Mexico, Florida, Mississippi, Arkansas, Alabama, Colorado, Montana, Wyoming, Idaho, North Dakota, South Dakota, California, Kansas, West Virginia, Ohio, and Michigan. False River Company of Baton Rouge, Louisiana is owned 50% by Bledsoe Energy Corporation which enables Bledsoe to have firsthand, advance knowledge of activities in the Tuscaloosa Trend in South Louisiana. Magnum Oil Corporation is owned 20% by Bledsoe and affords Bledsoe to timely information in the Appalachian Belt.

I. PRELIMINARY RESPONSES TO REQUESTS TO AGENCIES

1. COMMODITY FUTURES TRADING COMMISSION, INCLUDING ATTACHMENTS ON POSITION LIMITS IN PRECIOUS METALS

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W.
Washington, D.C. 20581

July 31, 1980

Ms. Barbara Timmer
Subcommittee on Commerce, Consumer &
Monetary Affairs
Committee on Government Operations
B-377 Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear ~~Ms. Timmer:~~ Barbara —

This letter will confirm our telephone conversation yesterday concerning Chairman Rosenthal's request of June 10, 1980. Commission staff has assembled most of the information requested. At this stage, senior Commission staff must review the material, which is voluminous. Senior staff will then forward the material to the Commission, with a recommendation that it be transmitted to the Subcommittee.

Since the Commission received Chairman Rosenthal's request, several factors have interfered with its orderly processing. Among these factors are the activities relating to the recent actions taken against the Chicago Board of Trade and the Chicago Mercantile Exchange regarding financial futures. Another major factor is the statutory requirement that this agency provide appropriate committees of Congress by October 1, 1980, an extensive report on the trading of silver futures and other commodities. These and other assignments have, of necessity, interrupted the time of the staff members who are preparing the response to Chairman Rosenthal's request.

We regret there is this delay, but I assure you it has been unavoidable. We will keep you informed of our progress in answering your request.

Sincerely,

Rick

Richard J. Feeney
Director
Office of Governmental Affairs

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

Read P. Dunn, Jr.
Commissioner

(202) 254-6318

August 21, 1980

Honorable Benjamin S. Rosenthal
Chairman
Subcommittee on Commerce, Consumer
and Monetary Affairs
Committee on Government Operations
United States House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

The Commission has been working on the response to the Subcommittee's June 10 request for information pertaining to activity in the silver markets during 1979 and 1980. On July 31, 1980, Mr. Feeney of our staff informed Ms. Timmer of your staff of our progress on this response as of that date.

We understand from your staff that this letter from the Commission is needed in order to be included in the printed record of your Subcommittee's hearings. Attached are the Commission's responses to Parts II, and V of your June 10 letter. We are continuing our assembly and review of Parts, I, III, IV and VI and will provide those to you in the near future. We will keep your staff apprised of our progress on this material.

The Commission is making this normally confidential data and information available to you in connection with a congressional proceeding as authorized by Section 8(b) of the Commodity Exchange Act. These data should be treated with the utmost confidentiality.

For the Commission,

Read P. Dunn, Jr.
Commissioner

Attachment

ATTACHMENT A

COMMODITY FUTURES TRADING COMMISSION

26 OCT 1979

MEMORANDUM

TO: The Commission

FROM: Donald L. Tendick
Executive Director

SUBJECT: Position Limits for Futures Markets in Precious Metals

OTHER OFFICE
CONCURRING: Division of Economics and Education

The recent dramatic price increases in the precious metals markets and continuing volatility of these prices have raised concerns regarding "excessive speculation" in these markets. At the Commission meeting of October 16, 1979, members of the Commission expressed a concern that -- in view of these recent market developments -- there may be a need for position limits for futures markets in precious metals. There was some discussion of the exchanges setting such limits -- if they are ultimately found to be necessary and appropriate. In addition, the staff was requested by the Commission to prepare for a general discussion of position limits in precious metals at the Commission meeting of October 30.

Background on Major Issues

The Commission has the authority under section 4a(1) of the Act (see attachment) to fix limits on positions in futures markets for any commodity for the purpose of "diminishing, eliminating or preventing" the adverse price effects of excessive speculation." A basic issue, however, is whether the recent price behavior in precious metals is due to "excessive speculation" and whether limits on speculative positions in futures markets would "diminish, eliminate or prevent" any adverse effects of such excessive speculation.

DI:mm:10/26/79

CONCURRENCES

SYMBOL ►							
SURNAME ►	B. Imel	D. Tendick					
DATE ►							

CFTC 33 7-76

OFFICIAL FILE COPY

The current conditions of uncertainty in the world economy, and the traditional image of precious metals as a store of value, make it difficult to determine whether current price behavior in precious metals markets is unwarranted or could be attributed to "excessive speculation." Furthermore, at this time, the staff has no information which suggests whether or not the price effects of any possible "excessive speculation" in precious metals would be curbed by limits on speculative futures positions as they have traditionally been established by either the federal government or the exchanges. This is due principally to two factors:

1. The general nature of recent price rises in the precious metals markets and the close connection between cash and futures markets for these commodities makes it difficult to attribute any of these price rises to futures markets alone. To the extent that excessive speculation prevails in the cash as well as the futures markets, the desirability and effectiveness of speculative limits on futures positions is diminished.

2. Traditionally, the speculative limits established and maintained by either the federal government or the exchanges have been for the purpose of preventing individual traders from establishing extraordinarily large speculative positions, and such limits only indirectly affect the total amount of speculative open interest in a given contract market. Therefore, to the extent that any excessive speculation in precious metals is general or dispersed among many persons trading futures, it will not be curbed by limits as they have traditionally been established. Further, it should be noted that any limits established pursuant to section 4a(1) of the Act cannot be applied retroactively to existing positions.

Alternatives

In view of the above, we believe that the alternative courses of action which the Commission may adopt are as follows:

A. Hold public hearings on the desirability and/or appropriateness of establishing position limits for futures trading in precious metals.

Pros:

1. Provides a public forum for interested persons (including other government agencies) to express their views on the issues, and may provide some insights into the pros and cons of establishing limits.

Cons:

1. If as a result of these hearings, the Commission decides that it will further pursue the question of limits, it is possible that another notice and opportunity for public hearing will be required pursuant to §4a(1) of the Act. (The Office of the General Counsel should address the issue.)

B. Request that the exchanges consider the question of establishing speculative position limits for precious metals futures, and that they do so if they find this course of action to be appropriate. 1/

Pros:

1. This alternative may allow establishment of limits more quickly than if the Commission were to pursue the matter pursuant to section 4a(1) of the Act. The contract markets have not in the past conducted extensive studies or held hearings prior to establishing their own speculative limits.

1/ On October 25, 1979, the Chicago Board of Trade announced that it is imposing speculative limits on positions in silver as follows: (1) No new net long or short positions in excess of 600 contracts in any month or combination of months will be allowed and (2) by February 1, 1980, all net long and short positions in any month except bona fide hedge positions must be reduced to the 600-contract limit.

Cons:

1. If any one of the major contract markets for each precious metal determines that speculative limits are inappropriate, the Commission might be required to pursue another course of action.

2. If all contract markets did determine to adopt speculative limits, there could be concerns over the appropriateness of the levels or the manner in which they would be applied.

C. Direct the CFTC staff to consider the major issues involved and make a recommendation concerning the adoption of speculative limits pursuant to section 4a(1) of the Act.

Pros:

1. If the exchanges determine that limits are not appropriate, this course of action may be necessary to resolve the issues.

2. If the Commission determines pursuant to section 4a(1) that limits are appropriate, any issues concerning the levels and the manner in which the limits would be applied could be more easily resolved than if the exchanges established them.

Cons:

1. The analysis and rulemaking proceedings which would be required to establish speculative limits pursuant to section 4a(1) of the Act will probably extend, at best, over several months.

2. The analysis and proceedings would divert considerable staff resources.

Attachment

[SPECULATIVE LIMITS ON DAILY TRADING AND POSITIONS]

Sec. 4a. (1) Excessive speculation in any commodity under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity. For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time, after due notice and opportunity for hearing, by order, proclaim and fix such limits on the amount of trading which may be done or positions which may be held by any person under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market as the Commission finds are necessary to diminish, eliminate, or prevent such burden. In determining whether any person has exceeded such limits, the positions held and trading done by any persons directly or indirectly controlled by such person shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person. Nothing in this section shall be construed to prohibit the Commission from fixing different trading or position limits for different commodities, markets, futures, or delivery months, or different trading limits for buying and selling operations, or different limits for the purposes of subparagraphs (2)(A) and (B) of this section, or from exempting transactions normally known to the trade as "spreads" or "straddles" or "arbitrage" or from fixing limits applying to such transactions or positions different from limits fixed for other transactions or positions. The word "arbitrage" in domestic markets shall be defined to mean the same as a "spread" or "straddle". The Commission is authorized to define the term "international arbitrage". [As amended by Act of October 23, 1974 (Commodity Futures Trading Commission Act of 1974), effective April 21, 1975, Sec. 403, 88 Stat. 1413.]

[Compliance with Trading Limits]

(2) The Commission shall in such order fix a reasonable time (not to exceed ten days) after the order's promulgation; after which, and until such order is suspended, modified, or revoked, it shall be unlawful for any person—

(A) directly or indirectly to buy or sell, or agree to buy or sell, under contracts of sale of such commodity for future delivery on or subject to the rules of the contract market or markets to which the order applies, any amount of such commodity during any one business day in excess of any trading limit fixed for one business day by the Commission in such order for or with respect to such commodity; or

(B) directly or indirectly to hold or control a net long or a net short position in any commodity for future delivery on or subject to the rules of any contract market in excess of any position limit fixed by the Commission for or with respect to such commodity: *Provided,* That such position limit shall not apply to a position acquired in good faith prior to the effective date of such order.

[Hedging Transactions Exception]

(3) No order issued under paragraph (1) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions or positions as such terms shall be defined by the Commission within one hundred eighty days after the effective date of the Commodity Futures Trading Commission Act of 1974 by order consistent with the purposes of this Act: *Provided,* That such terms shall permit the hedging of a person's anticipated production of seed quantities of a commodity and the hedging by the users of products of traded commodities as well as users of the commodities. [As amended by Act of October 23, 1974 (Commodity Futures Trading Commission Act of 1974), effective April 21, 1975, Sec. 404, 88 Stat. 1413; as amended April 16, 1975, Sec. 4, P. L. 94-16, 89 Stat. 77.]

ATTACHMENT B

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W.
Washington, D.C. 20581

May 6, 1980

ok for distribution

MEMORANDUM

TO: The Commission

FROM: James A. Culver, Director JAC
Division of Economics and Education

SUBJECT: Speculative Limits

At a public meeting in October 1979, the Commission considered the question of speculative limits in precious metals. Although it determined not to act at that time, the Commission agreed that the subject of speculative limits would be reagended at the request of any Commission member. At a recent surveillance briefing, Chairman Stone indicated that he would request the staff to agenda the topic for discussion and has done so. The purpose of this memorandum is to briefly summarize past consideration of this subject and to obtain Commission guidance on the manner in which it wishes the staff to proceed.

Background

Speculative limits have been established for 30 commodities in which markets are currently designated to trade. Limits in ten of those commodities are Commission imposed limits, the remaining commodities are subject to exchange limits (Attachment A) and are primarily in agricultural commodities. All Commission speculative limits currently in effect were established by the Commodity Exchange Authority (CEA). Although the Commission has not promulgated additional speculative limits, it has considered the findings of its Advisory Committee on the Economic Role of Contract Markets, which addressed this topic and recommendations prepared by the Office of the Chief Economist for Commission discussion in November 1977.

Past Policy on Limits

The first speculative limits were established approximately two years after the Commodity Exchange Act superceded the Grain Futures Act in 1936. Public hearings were held concerning limits on grains 1/ in late 1937 and these limits were established in late 1938. At the hearings concerning limits on grains, economists testifying for the Commodity Exchange Authority stated that they saw little value in certain extraordinary large speculative trades and positions--either in terms of assisting in price discovery or in facilitating the market's hedge load. In addition, during these and subsequent proceedings on limits, research findings were presented which demonstrated that prices moved with increasing frequency in the direction of large traders as trade size increased. These statistical analyses did not, however, support any specific level for speculative limits. In retrospect, the exact level at which speculative limits were set appears to have been determined by other criteria.

A review of these past proceedings conducted by CEA staff reveals that speculative limits were set at (or subsequently adjusted to) a level near the outer bounds of the observed distributions of speculative positions and daily trades Attachment B). Consequently, only the activities of the largest market participants were constrained. The market was still allowed to adjust freely and properly to changes in supply and demand conditions and to provide the liquidity to service hedgers. Position limits applied to the net long or net short position in any one future and in all futures combined. Spread positions were generally not exempted from the limits on individual futures. 2/

The policy followed by exchanges in setting position limits has not been analyzed in detail, although there is evidence that for more active markets, the same result would have been achieved using CEA policy.

1/ Defined at that time to include wheat and corn as well as oats, barley and flaxseed.

2/ Spreads in cotton are exempt from the limits on individual futures except during the delivery month. The original limits for grains contain a special provision for intermarket spreading.

Past Commission Considerations of Speculative Limits

As mentioned, supra, at page 2, the Commission has considered the report of its Advisory Committee which addressed the subject of speculative limits (Attachment C) and recommendations concerning speculative limits prepared by the Office of the Chief Economist (Attachment D). It appears that an underlying premise of both the findings of the Advisory Committee and the staff recommendations was that speculative limits, when established, should provide some measure of protection to the market during the delivery month. Other experience, particularly recent events in the silver futures markets, suggest that speculative limits may need to be established for other purposes.

Report of the Advisory Committee on the Economic Role of Contract Markets - The Advisory Committee discussed a variety of issues involved with speculative limits. In general, the Committee concluded that speculative limits, in their current status, were not a particularly useful regulatory tool and, in some ways, could damage the competitive nature of the markets.

Two important conclusions reached in the Advisory Committee's report were that (1) speculative position limits are not a very powerful tool for the Commission in its futures markets regulatory role, nor can they be made to be, and (2) that speculative position limits provide almost no help in the crucial delivery months.

Although the Advisory Committee did not recommend abolishing position limits, it stated that the limits should be supplemented by a comprehensive surveillance effort. Two members of the committee felt that limits were useful but the current Federal limits were too low and should be raised.

November 1977 Staff Recommendations

The 1977 staff paper was prepared to identify and discuss various issues involved in the Commission's authority to set speculative limits. In particular, three major policy questions were addressed: (1) whether there should be limits and for what groups of commodities, (2) what guidelines are appropriate in setting the level of limits, and

(3) who (CFTC or the exchanges) should set the limits. In addition, the covering memorandum to the Commission recommended the "25 Percent Rule" as an alternative to speculative limits.

With respect to setting speculative limits, the recommendation of the Chief Economist was that the "safety net guideline" be used. As stated in the staff analysis, the objective of such limits "would be to allow the market the latitude to function competitively but to limit those positions which are extraordinary in character and represent potentially abusive power."

The final portion of the paper addressed the issue of who should set the limits in those commodities where they are judged desirable. It concluded that the exchanges have the necessary expertise and could establish and review limits more efficiently than the Commission.

The Commission adopted the staff recommendation that the 25 Percent Rule be published for public comment. As proposed, this rule would have limited all positions in an expiring future to a fixed percentage of the open interest, unless the exchange made a determination that positions exceeding the fixed amount did not constitute a threat to orderly trading. However, on review, the staff concluded that at times there may not be sufficient information available to the exchanges to allow them to make a valid determination as required by the rule. Consequently, the Commission did not take any further action with respect to the proposed rule.

Current Considerations

As mentioned above, concern over an inability to deal with maturing futures problems through speculative limits appears to underlie the findings of the advisory committee and those of the Office of the Chief Economist with respect to the effectiveness of speculative limits. Recent activity in the silver market, however, suggests that speculative limits may serve broader public interest purposes. As noted in the November 1977 Staff Analysis, a trader's net position has a continual effect on price, and if sufficiently large can become a perceptible market factor. In this context, speculative position limits tend to decrease the potential for positions to influence the general price level. Moreover, by limiting the ability of persons to obtain extraordinarily large open positions, speculative limits diminish the possibility of accentuating price swings if such positions must be liquidated in the face of adverse price movements or for other reasons.

If for these or similar reasons the Commission determines that speculative position limits are desirable in each market, then the staff requires guidance on how to proceed in the following two areas:

1. the method to be used for determining limits; and

2. who should set the limits, the exchanges or the Commission.

With respect to the method used for setting limits, the Division's review indicates that the "safety net" method has been the focus of extensive analysis and discussion in the past and would be appropriate for use.

This method involves setting speculative limits near the outer bound of the observed distribution of speculative positions taking into account the size of positions held by commercials in a particular market to determine where the exact level should be set. The alternative to this is for the Division to develop some new methodology.

Limits established under this method would curtail speculative positions which are extraordinarily large and pose a market threat but the use of the size of commercial positions would allow flexibility in determining how far out in the distribution the level should be set. This method also minimizes potential costs to the market which would be incurred if limits are set too low (i.e., reduced liquidity and impairing the markets ability to handle the hedge load).

With respect to the question of who should set limits, the Office of the Chief Economist in 1977 had recommended that the exchanges should be required to set and enforce speculative limits. The primary reasons for this recommendation were as follows:

1. The exchanges have the greatest expertise in a particular commodity for establishing specific limits;

2. As self regulatory entities, the exchanges should be responsible for setting limits. In addition, it would shift much of the regulatory costs of establishing and administering the program to the exchanges.

3. the Commission would review and approve the limits under §5a(12) of the Act, thus retaining some control over levels.

Under this approach, the Commission, for example, might under Sections 8a(5) and 4a(1) of the Act, promulgate guidelines on the establishment of speculative limits by the exchanges.

Another alternative would be for the Commission to set its own levels under Section 4a(1) of the Act. Advantages resulting from this approach would include:

1. The limits could be made consistent for different markets in the same commodity. This result would at best be difficult to achieve if different exchanges with markets in the same commodity set their own limits;

2. The Commission could apply its own aggregation standards and hedging exemptions uniformally to all markets; and

3. If the methodology discussed above is used, the Division can minimize the amount of resources required to set limits. While in theory having limits set by the exchange and reviewed by CFTC would save on CFTC resources, in reality that is doubtful. It may well be that the most efficient use of resources would be for the Commission to set limits.

Recommendations concerning other particularly more technical questions regarding setting limits will be developed in subsequent staff analyses at the direction of the Commission.

Attachments

ATTACHMENT A

COMMODITIES IN WHICH SPECULATIVE POSITION LIMITS ARE IN EFFECT

Commission Limits

Wheat
Corn
Oats
Rye
Barley
Flaxseed
Soybeans
Eggs
Potatoes
Cotton

Exchange Limits

Sunflower Seeds - MGE
Sorghums - CME
Soybean Oil - CBT
Soybean Meal - CBT
Butter - CME
Frozen Eggs - CME
Iced Broilers - CBT
Iced Broilers - CME
Live Cattle - CME
Live Cattle - MACE
Feeder Cattle - CME
Live Hogs - CME
Live Hogs - MACE
Frozen Boneless Beef - CME
Frozen Hams - CME
Frozen Pork Bellies - CME
Frozen Pork Bellies - MGE
Turkeys - CME
Lumber - CME
Stud Lumber - CME
Plywood - CBT
Silver - CBT
Silver - CEI
*Copper - CEI
GNMA - CBT

* Established only on a temporary emergency basis.

2. DEPARTMENT OF JUSTICE

U. S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General
Washington, D.C. 20530

June 11, 1980

[illegible]
STAFF
FWD.
COMMENTS
FILE CODE

Honorable Benjamin S. Rosenthal
Chairman
Subcommittee on Commerce, Consumer
and Monetary Affairs
Committee on Government Operations
House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

This is to acknowledge receipt of your June 10, 1980 letter to the Attorney General transmitting the transcript from your recent hearings about the Hunt brothers speculation and the collapse of the silver market.

Your letter is now being reviewed within the Department and you will receive a response as soon as possible.

Sincerely,

Alan A. Parker

Alan A. Parker
Assistant Attorney General

ASSISTANT ATTORNEY GENERAL
LEGISLATIVE AFFAIRS

Department of Justice
Washington, D.C. 20530

August 4, 1980

Honorable Benjamin S. Rosenthal
Chairman
Commerce, Consumer and Monetary
Affairs Subcommittee
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing to respond to your letter of June 10, 1980, in which you pointed out certain suggested discrepancies between the testimony given on May 2, 1980 by William Herbert Hunt and Nelson Bunker Hunt and a statement given to the subcommittee staff on May 23, 1980 by Bill Bledsoe, and requested the Department of Justice to undertake an investigation into the matter.

Following receipt of your letter, senior attorneys in the Criminal Division have reviewed the relevant testimony, interviewed Mr. Bledsoe, and conducted other appropriate preliminary inquiries. We have determined that proof that perjury was committed before your subcommittee would necessarily entail proof of an underlying, concerted course of conduct designed to corner or manipulate the market for silver or the related trading markets. As you know, the Commodity Futures Trading Commission has already begun a full investigation into possible manipulation of the silver markets by the Hunt brothers and the Securities and Exchange Commission is investigating related matters which fall within its jurisdiction. We believe that it is appropriate for us to await the preliminary results of these inquiries before making a final determination whether to initiate a full investigation of the suggested testimonial discrepancies or the underlying trading in the silver markets.

The information in Mr. Bledsoe's statement relating to possible irregular transactions designed to secure tax advantages has been separately referred to the Internal Revenue Service.

Sincerely yours,

Alan A. Parker

Alan A. Parker
Assistant Attorney General
Office of Legislative Affairs

3. INTERNAL REVENUE SERVICE

COMMISSIONER OF INTERNAL REVENUE
Washington, DC 20224

JUL 18 1980

The Honorable Benjamin S. Rosenthal
Chairman, Subcommittee on Commerce,
  Consumer and Monetary Affairs
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your letter of July 9, 1980, regarding the information provided by Mr. Bledsoe to your Subcommittee concerning the Hunts. I will forward this information to the appropriate IRS personnel in the field.

As you know, we are prohibited by Section 6103 of the Internal Revenue Code from disclosing the status of any taxpayer investigation unless the taxpayer consents or an appropriate House Resolution is passed.

With kind regards,

Sincerely,

CONGRESSMAN BEN ROSENTHAL
RECEIVED
STAFF ______ DOC # ______
REC # ______
JUL 24 1980
PARA: ______
COMMENTS: ______
FILE CODE

Internal Revenue Service **Department of the Treasury**

Assistant
Commissioner
(Compliance)

Washington, DC 20224

The Honorable Benjamin S. Rosenthal
Chairman, Subcommittee on Commerce,
Consumer and Monetary Affairs
U.S. House of Representatives
Washington, DC 20515

AUG 6 1980

Dear Mr. Chairman:

Commissioner Kurtz has asked me to respond to your July 9, 1980 letter which furnished information concerning the speculative dealings in silver by the Hunt brothers.

I appreciate your interest in directing this matter to our attention. The background material received with your letter has been forwarded to our appropriate field officials for evaluation and appropriate attention.

With kind regards,

Sincerely,

P.E. Coates

P. E. Coates

PARA.
COMMENTS.
FILE CODE.

4. SECURITIES AND EXCHANGE COMMISSION

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE COMMISSIONER

July 30, 1980

The Honorable Benjamin S. Rosenthal,
Chairman
Commerce, Consumer and Monetary
Affairs Subcommittee of the
Committee on Government Operations
U.S. House of Representatives
Rayburn House Office Building, Room B-377
Washington, D.C. 20515

Dear Chairman Rosenthal:

In his absence, Chairman Williams has asked me to respond to your letter, dated June 10, 1980, in which you request from the Commission certain information and data in connection with the hearings of the Commerce, Consumer and Monetary Affairs Subcommittee of the House Committee on Government Operations ("the Subcommittee") on recent events in the silver markets, their impact on related financial markets and the supervision of these markets by the responsible federal agencies.

As Chairman Williams informed the Subcommittee in his testimony, this agency is conducting a non-public fact finding investigation into certain of the events which are the subject of the Subcommittee's inquiry. That investigation is focused principally, though not exclusively, on the role of entities registered with and reporting to the Commission in financing speculative silver positions, the effect of the price collapse in silver on those entities and other entities filing periodic reports with the Commission, and the nature and extent of the relationships among these entities and certain silver market participants. Our investigation, which we are coordinating with other interested federal agencies, is ongoing, and we have not as yet arrived at any conclusions concerning the responsibilities of any individuals or entities involved in the activities under investigation.

The Commission has endeavored to cooperate fully with the Subcommittee, and we intend to continue that cooperation as the Subcommittee attempts to complete its hearing record. Accordingly, we are submitting the following answers to the questions posed in your June 10 letter. In addition, we have enclosed, to the extent available, the documents called for in certain of your questions. We have also tried to make our answers as fully responsive as possible consistent with the discussions our staff have had with the staff of the Subcommittee to clarify certain requests contained in the June 10, 1980 letter.

QUESTION I:

Mr. Bledsoe's statement describes aggregate trading practices by the Hunts, characterized in various ways as part of a "plan", "strategy" or done "in concert". (See pp. 7-8, 17-24, 33)

1. Which Hunts and Hunt entities did the SEC treat in aggregate for reporting purposes as of August 1, 1979? As of June 1, 1980?
2. Assuming Mr. Bledsoe's description of the Hunt's trading to be accurate and using the attached Hunt entities list, when did aggregate Hunt ownership in Bache exceed the 5 percent limit which triggers the SEC 13-D reporting requirement?
3. Give the date actually filed and attach the 13D form.
4. Using the attached entities list, what additional publicly-held and traded companies are 5 percent or more owned or controlled by aggregate Hunt interests?

RESPONSE TO QUESTION I:

This response assumes that paragraph 1 of Question I relates to the aggregation of the holdings of individuals or entities in connection with the ownership reporting provisions of Section 13(d) of the Securities Exchange Act of 1934 ("Section 13(d)") and the rules and regulations promulgated thereunder. On each of the dates which are the subject of Question I, Section 13(d) required any person to file a report on Schedule 13D with the Commission, and send copies of such reports to the issuer and certain securities exchanges within ten days of the acquisition of more than 5% of the class of securities registered under Section 12 of the Securities Exchange Act of 1934 ("Exchange Act"). 1/ Moreover, such person is also required to file amendments promptly after any material change in the information previously disclosed in the Schedule 13D.

Whether the purchases of two or more persons are aggregated and treated as purchases by a single entity is governed by the terms of Section 13(d) and the facts and circumstances involved. Section 13(d)(3) specifies as follows:

> When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a "person" for the purposes of this subsection.

Similarly, Rules 13d-3(a) and (b) promulgated by the Commission pursuant to Section 13(d), define as a "beneficial owner" for purposes of Section 13(d) any person who (1) directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise has or shares voting or investment power with respect to a security or (2) divests himself of

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1/ While Section 13(d) applies to classes of equity securities registered pursuant to Section 12 of the Exchange Act, and to any equity security of an insurance company which would have been required to be registered except for the exemption contained in Section 12(g)(2)(G) of the Exchange Act and any equity security issued by a closed-end investment company registered under the Investment Act of 1940, Section 13(d) does not pertain to certain public companies, such as those issuers who file with the Commission pursuant to Section 15(d) of the Exchange Act.

beneficial ownership as a technique to evade the reporting requirements. 2/

According to the information that William Herbert Hunt ("W.H. Hunt") and Nelson Bunker Hunt ("N.B. Hunt") have supplied to the Subcommittee, N.B. Hunt beneficially owns 288,350 shares and W.H. Hunt beneficially owns 288,250 shares of Bache Group Inc. common stock ("Bache stock"). To date, W.H. Hunt and N.B. Hunt have not filed with the Commission, either individually or collectively, a statement on Schedule 13D with respect to their ownership of Bache stock.

On or about July 9, 1980, Placid Investments, Ltd., ("Investments"), a Texas limited partnership of which Placid Investment Company is the sole general partner, 3/

2/ Rules 13d-3(a) and (b) provide as follows:

> (a) For the purposes of Sections 13(d) and 13(g) of the [Exchange] Act a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares:
>
> (1) Voting power which includes the power to vote, or to direct the voting of, such security; and/or
>
> (2) Investment power which includes the power to dispose, or to direct the disposition of, such security.
>
> (b) Any person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement, or device with the purpose or effect of divesting such person of beneficial ownership of a security or preventing the vesting of such beneficial ownership as part of a plan or scheme to evade the reporting requirements of Sections 13(d) or 13(g) of the Act shall be deemed for purposes of such sections to be the beneficial owner of such security.

3/ Placid Investment Company is wholly-owned by the Placid Oil Company, a Delaware corporation owned by certain trusts, the beneficiaries of which are, among others, W.H. Hunt and N.B. Hunt.

filed with the Commission a statement on Schedule 13D with respect to the acquisition by Investments from W.H. Hunt and N.B. Hunt on May 27, 1980 of powers of attorney with respect to the 576,600 shares of Bache stock. The Schedule 13D filed by Investments is enclosed as Exhibit A. The Commission's files reflect no other statement on Schedule 13D filed with the Commission with respect to the Bache stock by W.H. Hunt, N.B. Hunt or individuals or entities identified as being related to such persons.

Whether or not N.B. Hunt, or W.H. Hunt or any Hunt-related individuals or entities should have aggregated their holdings for beneficial reporting purposes with respect to the Bache stock is a factual question which is a subject of the Commission's continuing investigation and therefore, we are not in a position to answer that question at this time.

With respect to Paragraph 4 of Question I, the Commission staff has reviewed the Commission's files relating to those companies with respect to which N.B. Hunt, W.H. Hunt or any Hunt-related individuals or entities have disclosed financial interests in their responses to the Subcommittee's interrogatories of May 9, 1980. This review has revealed statements on Schedule 13D filed by W.H. Hunt, N.B. Hunt or Hunt-related individuals or entities with respect to the acquisitions of securities of Global Marine, Inc. and Gulf Resources and Chemical Corporation. We enclose these statements as Exhibits B and C, respectively. Moreover, there have been voluminous filings with the Commission of statements on Schedule 13D by W.H. Hunt, N.B. Hunt and Hunt-related individuals with respect to Great Western United Corp. ("GWU") and its successor, Hunt International Resources Corporation ("HIRCO"). Enclosed herein as Exhibit D is a copy of Amendment No. 1 of the statement on Schedule 13D filed with the Commission with respect to HIRCO by Planet Investment Corporation, a Hunt related entity, on October 22, 1979. If requested, the Commission would be happy to supply the Subcommittee with copies of the other statements on Schedule 13D and the amendments thereto with respect to GWU and HIRCO which were filed with the Commission.

The Commission's files do not necessarily reflect every public company in which N.B. Hunt, W.H. Hunt, or Hunt-related individuals or entities own 5% or more of the outstanding common stock, either individually or when their interests are aggregated. As discussed above, a review of filings with the Commission will reveal the beneficial owners of five percent or more of a company's securities only if such persons have complied with Section 13(d) by filing a statement on Schedule 13D. Further, such filings with the Commission are indexed by issuer and not by the acquiring party; therefore a search can only be made of the Commission's files by issuer to determine if a particular person has reported his ownership of more than 5% of the outstanding common stock of the issuer.

QUESTION II:

Mr. Bledsoe describes certain business and trading practices by the Hunts in connection with several publicly-held companies (beginning on p. 37 of his statement). He suggests that the Hunt company Penrod Drilling, may have appropriated trade secrets while leased to Hunt Energy Competitors such as Chevron and Shell. In addition, while the Hunts controlled Great Western United and before it was taken private, the company may have traded commodities publicly in a way designed to benefit personal Hunt silver holdings (pp. 19-20); and a subsidiary of Great Western, Impel, may have given valuable oil information to Hunt Energy rather than its parent company.

1. Assuming Mr. Bledsoe's statement to be accurate, what potential violations of SEC-administered law are involved?

RESPONSE TO QUESTION II:

During the discussions between the staffs of the Commission and the Subcommittee, it was agreed that Question II would be modified to request the Commission to discuss certain disclosure requirements of the federal securities laws with respect to related party and other transactions without relating such requirements to the statements by Mr. Bledsoe which are referred to in the Question.

Under the federal securities laws, publicly-held corporations are subject to a number of reporting requirements. Among other things, a publicly-held corporation is required to file with the Commission periodic reports including (1) an annual report, containing audited financial statements; (2) quarterly reports; (3) current reports; and (4) proxy statements sent to shareholders. These reports in varying degrees require detailed disclosures about the business operations and financial condition of the company as well as the interest of management, directors and other controlling persons in transactions with the company. 4/

The failure to disclose transactions between a reporting company and such persons may violate one or more of the reporting requirements. For example, an issuer in its proxy statement to shareholders is required to make accurate disclosure of any transactions between the reporting company and any officer, director, 5% shareholder or any relative or spouse of the foregoing.

With respect to all statements or reports filed with the Commission under the Exchange Act, Rule 12b-20 requires that, in addition to information expressly required to be included, the reporting company shall add "such further material information, if any, as may be necessary to make the required statements in the light of the circumstances under which they are made not misleading." Although the reporting requirements of the Exchange Act run to the issuer, other persons may be found to have violated such provisions on several theories of derivative liability. In addition to reports filed by the issuer and those filed pursuant to Section 13(d), Section 16 of the Exchange Act requires officers, directors and ten percent holders to file reports disclosing purchases and sales of the issuer's securities.

4/ See, e.g., Item 4 of Regulation S-K which requires disclosure of management remuneration, including perks, and transactions with management and Item 6 of Regulation S-K which requires disclosure of beneficial ownership by officers, directors and holders of more than five percent of the issuer's securities.

QUESTION III:

Attach the quarterly reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 filed by the Bache Group Inc. for 1979 and the first two quarters of 1980. For each of those six dates, summarize the following information:

1. Under "Assets" the categories and amounts of the various "Securities and commodities" pledged as collateral for bank loans and letters-of-credit agreements used in any way for Hunt silver trading.
2. Under "Other Assets", the amount of silver and location.
3. Under "Liabilities", "Other Liabilities", those involved in any way with Hunt silver trading.
4. Under "Revenues", "Commodities", the amount of silver and location.
5. Under "Contingent Liabilities", the amount of bank guarantees and letter-of-credit agreements used in lieu of margin deposits for commodity trading.
6. The amount in this same category (five above) specifically for silver trading.
7. The amount in the same category (five above) specifically for the Hunts' trading.

RESPONSE TO QUESTION III:

The securities of Bache Group Inc. are registered with the Commission pursuant to Section 12(b) of the Exchange Act. Bache Group Inc. has numerous subsidiaries; one wholly-owned subsidiary is Bache Halsey Stuart Shields Incorporated, a broker-dealer registered with the Commission. The periodic reports enclosed as Exhibit E pursuant to Question III have been reviewed for the purposes of answering paragraphs 1-7 of Question III.

Paragraphs 1-4:

The information requested by these paragraphs is not ascertainable from the reports reviewed.

Paragraph 5:

A review of the periodic reports reveals the following: 5/

Quarterly Report on Form 10-Q for Quarter Ended April 30, 1980:

The Company was contingently liable as of April 30, 1980 in the amount of $72,817,000 under bank guarantees and letter of credit agreements used in lieu of margin deposits. These agreements are generally made for periods of six months to one year and bear interest at the rate of 1/4% per annum.

Quarterly Report on Form 10-Q for Quarter Ended January 31, 1980:

The Company was contingently liable as of January 31, 1980 in the amount of $160,592,000 under bank guarantees and letter of credit agreements used in lieu of margin deposits. These agreements are generally made for periods of six months to one year and bear interest at the rate of 1/4% per annum.

Quarterly Report on Form 10-Q for Quarter Ended October 31, 1979:

The Company was contingently liable as of October 31, 1979 in the amount of $80,493,000 under bank guarantees and letter of credit agreements used in lieu of margin deposits. These agreements are generally made for periods of six months to one year and bear interest at the rate of 1/4% per annum.

5/ The language contained the textual discussions of Contingent Liability in response to Questions III and IV is quoted directly from the periodic reports cited therein.

Paragraph 5 (Continued):

Annual Report on Form 10-K for Fiscal Year Ended July 31, 1979:

The Company was contingently liable as of July 31, 1979 in the amount of $68,892,000 under bank guarantees and letter of credit agreements used in lieu of margin deposits. These agreements are generally made for periods of six months to one year and bear interest at the rate of 1/4% per annum.

Quarterly Report on Form 10-Q for Quarter Ended April 30, 1979:

The Company was contingently liable as of April 30, 1979 in the amount of $77,597,000 under bank guarantees and letter of credit agreements used in lieu of margin deposits. These agreements are generally made for periods of six months to one year and bear interest generally at 1/4% per annum.

Quarterly Report on Form 10-Q for Quarter Ended January 31, 1979:

The Company was contingently liable as of January 31, 1979 in the amount of $91,975,000 under bank guarantees and letter of credit agreements used in lieu of margin deposits. These agreements are generally made for periods of six months to one year and bear interest generally at 1/4% per annum.

Paragraphs 6 and 7:

There are no separate figures under Contingent Liabilities as to silver trading or the Hunts' trading as requested by these paragraphs.

QUESTION IV:

Attach quarterly reports for the same six time periods for the following brokerage firms:

a. ACLI International
b. E.F. Hutton
c. Mocatta Metals
d. Heinhold Commodities Inc.
e. Merrill Lynch
f. Paine Webber
g. Clayton Brokerage Co.
h. Dean Witter Reynolds
i. A.C. Edwards
j. Shearson, Loeb, Rhoades
k. Cargill Investor Services
l. ContiCommodities Services, Inc.

For each of the firms, summarize the same information requested in 1-7, III above.

RESPONSE TO QUESTION IV:

E.F. HUTTON GROUP INC.

The securities of the E.F. Hutton Group Inc. are registered with the Commission pursuant to Section 12(b) of the Exchange Act. The E.F. Hutton Group Inc. has two principal subsidiaries, one of which is E.F. Hutton & Company Inc. ("EFH"), a broker-dealer registered with the Commission. The periodic reports enclosed as Exhibit F pursuant to Question IV have been reviewed for the purposes of answering paragraphs 1-7 of Question III. 6/

Paragraphs 1-4:

The information requested is not ascertainable from the reports reviewed.

Paragraph 5:

A review of the periodic reports reveals the following:

6/ The Quarterly Report required to be filed by E.F. Hutton Group Inc. for the quarter ended June 30, 1980, has not yet been received by the Commission. It is due by August 14, 1980.

Paragraph 5 (Continued):

Annual Report on Form 10-K for Fiscal Year Ended December 31, 1979:

EFH was contingently liable as of December 31, 1979, in the amount of $116,769,000 under letter of credit agreements used in lieu of margin deposits with certain options and commodities clearing associations. These agreements are generally made for periods of one to six months and bear interest at 1/4%.

The other reports reviewed do not contain information requested by this paragraph. 7/

Paragraphs 6-7:

There are no separate figures under Contingent Liabilities as to silver trading or the Hunts' trading as requested by these paragraphs.

MERRILL LYNCH & CO. INC.

The securities of Merrill Lynch & Co. Inc. are registered with the Commission pursuant to Section 12(b) of the Exchange Act. Merrill Lynch & Co. Inc. has numerous subsidiaries, one of which is Merrill Lynch, Pierce, Fenner & Smith, Incorporated, a broker-dealer registered with the Commission. The periodic reports enclosed as Exhibit G pursuant to Question IV have been reviewed for the purpose of answering paragraphs 1-7 of Question III. 8/

Paragraphs 1-4:

The information requested by these paragraphs is not ascertainable from the reports reviewed.

7/ Quarterly Reports on Form 10-Q are not required to include information on Contingent Liabilities except to the extent necessary to make the information presented not misleading.

8/ The Quarterly Report required to be filed by Merrill Lynch & Co. Inc. for the quarter ended June 30, 1980, has not yet been received by the Commission. It is due by August 14, 1980.

Paragraph 5:

A review of the periodic reports reveals the following:

Quarterly Report on Form 10-Q for Quarter Ended March 28, 1980:

In the normal course of business, the Corporation uses letters of credit and enters into when-issued, underwriting, and delayed delivery commitments. The settlement of these transactions, which were open as of March 28, 1980, is not expected to have a material effect on the consolidated financial condition of the Corporation as of that date.

Annual Report on Form 10-K for Fiscal Year Ended December 28, 1979:

In the normal course of business, the Corporation uses letters of credit (approximately $480,000,000 at December 28, 1979) and enters into various commitments including when-issued, underwriting, and delayed delivery commitments. At December 28, 1979, unsettled GNMA purchase and sale commitments approximated $970,000,000 and $1,020,000,000, respectively. The settlement of these transactions, which were open as of December 28, 1979, is not expected to have a material effect on the consolidated financial condition of the Corporation as of that date.

Quarterly Report on Form 10-Q for the Quarter Ended September 28, 1979:

In the normal course of business, the Corporation uses letters of credit and enters into when-issued, underwriting, and delayed delivery commitments. The transactions relating to such commitments which were open as of September 28, 1979 had no material effect on the consolidated financial condition of the Corporation as of that date.

Quarterly Report on Form 10-Q for Quarter Ended June 29, 1979:

In the normal course of business, the Corporation uses letters of credit and enters into when-issued, underwriting,

Paragraph 5 (Continued):

and delayed delivery commitments. The transactions relating to such commitments which were open as of June 29, 1979 had no material effect on the consolidated financial condition of the Corporation as of that date.

Quarterly Report on Form 10-Q for Quarter Ended March 30, 1979:

In the normal course of business, the Corporation uses letters of credit and enters into when-issued, underwriting, and delayed delivery commitments. The transactions relating to such commitments which were open as of March 30, 1979 had no material effect on the consolidated financial condition of the Corporation as of that date.

Paragraphs 6-7:

There are no separate figures under Contingent Liabilities as to silver trading or the Hunts' trading as requested by these paragraphs.

PAINE WEBBER INC.

The securities of Paine Webber Inc. are registered with the Commission pursuant to Section 12(b) of the Exchange Act. Paine Webber Inc. has two operating subsidiaires, one of which is Paine, Webber, Jackson & Curtis, Inc. ("PWJC"), a broker-dealer registered with the Commission. The periodic reports enclosed as Exhibit H pursuant to Question IV have been reviewed for the purposes answering paragraphs 1-7 of Question III. 9/

Paragraphs 1-4:

The information requested by these paragraphs is not ascertainable from the reports reviewed.

9/ The Quarterly Report required to be filed by Paine Webber Inc. for the quarter ended June 30, 1980, has not yet been received by the Commission. It is due by August 14, 1980.

Paragraph 5:

A review of the periodic reports reveals the following:

Quarterly Report on Form 10-Q for Quarter Ended March 31, 1980:

As of March 31, 1980, PWJC was contingently liable in the amount of $106,800,000 under letter of credit agreements used in lieu of margin deposits. The agreements are usually made for six months at rates of from 1/4 to 1/2%.

Quarterly Report on Form 10-Q for Quarter Ended December 31, 1979:

As of December 31, 1979, PWJC was contingently liable in the amount of $130,844,000 under letter of credit agreements used in lieu of margin deposits. The agreements are usually made for six months at rates of 1/4%.

Annual Report on Form 10-K for the Fiscal Year Ended September 28, 1979:

As of September 28, 1979, the Company was contingently liable in the amount of $70,567,000 under unsecured letter of credit agreements used in lieu of margin deposits. The agreements are currently made for six months at annual rates of 1/4%.

Quarterly Report on Form 10-Q for Quarter Ended June 30, 1979:

As of June 30, 1979, PWJC was contingently liable in the amount of $71,365,800 under letter of credit agreements used in lieu of margin deposits. The agreements are usually made for six months at rates of from 1/4 to 1/2%.

Quarterly Report on Form 10-Q for Quarter Ended March 31, 1979:

As of March 31, 1979, PWJC was contingently liable in the amount of $68,957,000 under letter of credit agreements used in lieu of margin deposits. The agreements are usually made for six months at rates of from 1/4 to 1/2%.

Paragraphs 6-7:

There are no separate figures under Contingent Liabilities as to silver trading or the Hunts' trading as requested by these paragraphs.

DEAN WITTER REYNOLDS ORGANIZATION INC.

The securities of Dean Witter Reynolds Organization Inc. are registered with the Commission pursuant to Section 12(b) of the Exchange Act. Dean Witter Reynolds Organization Inc. has three principal subsidiaries, one of which is Dean Witter Reynolds Inc., a broker-dealer registered with the Commission. The periodic reports enclosed as Exhibit I pursuant to Question IV have been reviewed for the purposes of answering paragraphs 1-7 of Question III.

Paragraphs 1-4:

The information requested by these paragraphs is not ascertainable from the reports reviewed.

Paragraph 5:

A review of the periodic reports reveals the following:

Annual Report on Form 10-K for Fiscal Year Ended August 31, 1979:

> Letters of Credit - The Company has irrevocable letters of credit ($23,367,000) and a revocable letter of credit ($34,500,000) which expire on various dates through September 7, 1980. These letters of credit with three banks are written in favor of clearing associations to satisfy margin requirements. At August 31, 1979 the Company had a contingent liability of $52,993,000 representing the margin requirements of such associations. Fees of 1/4% per annum are paid on the amount of these letters of credit.

The other reports reviewed do not contain information requested by this paragraph.

Paragraphs 6-7:

There are no separate figures under Contingent Liabilities as to silver trading or the Hunts' trading as requested by this paragraph.

A.G. EDWARDS & SONS INC.

The securities of A.G. Edwards & Sons Inc. are registered with the Commission pursuant to Section 12(b) of the Exchange Act and A.G. Edwards & Sons Inc. is registered with the Commission as a broker-dealer. The periodic reports enclosed as Exhibit J pursuant to Question IV have been reviewed for the purposes of answering paragraphs 1-7 of Question III.

Paragraphs 1-4:

The information requested by these paragraphs is not ascertainable from the reports reviewed.

Paragraph 5:

A review of the periodic reports reveals the following:

Annual Report on Form 10-K for the Year Ended February 29, 1980:

> As of February 29, 1980, the Company was contingently liable under letter of credit agreements in the amount of $31,928,000, principally to satisfy margin deposit requirements with a clearing corporation. Such agreements are generally for periods of six months to one year and bear interest at rates from 1/4% to 1/2%.

Annual Report on Form 10-K for Year Ended February 25, 1979:

> As of February 28, 1979, the Company was contingently liable under letter of credit agreements in the amount of $11,390,000, principally to satisfy margin deposit requirements with a clearing corporation. Such agreements are generally for periods of six months to one year and bear interest at rates from 1/4% to 1/2%.

The other reports reviewed do not contain information requested by this paragraph.

Paragraphs 6-7:

There are no separate figures on Contingent Liabilities as to silver trading or the Hunts' trading as requested by these paragraphs.

SHEARSON LOEB RHOADES INC.

The securities of Shearson Loeb Rhoades Inc. (prior to January 1980, this company was Shearson Hayden Stone Inc.) are registered with the Commission pursuant to Section 12(b) of the Exchange Act and Shearson Loeb Rhoades Inc. is registered with the Commission as a broker-dealer. The periodic reports enclosed as Exhibit K pursuant to Question IV have been reviewed for the purposes of answering paragraphs 1-7 of Question III. 10/

Paragraphs 1-4:

The information requested by these paragraphs is not ascertainable from the reports reviewed.

Paragraph 5:

A review of the periodic reports reveals the following:

Annual Report on Form 10-K for Fiscal Year Ended June 30, 1980:

> At June 30, 1979, the Company is contingently liable for letters of credit aggregating $100,191,000 used to satisfy margin deposits at option and commodity exchanges.

The other reports reviewed did not contain information requested by this paragraph.

10/ The Quarterly Report for the quarter ended June 30, 1980 has not yet been received by the Commission. It is due August 14, 1980.

Paragraphs 6-7:

There are no separate figures under Contingent Liabilities as to silver trading or the Hunts' trading as requested by these paragraphs.

OTHER ENTITIES

Some of the entities listed under Question IV are neither publicly traded companies nor broker-dealers registered with the Commission. Moreover, such entities do not file periodic reports with the Commission pursuant to Sections 13 or 15(d) of the Act. These entities are:

ACLI International

Mocatta Metals

Heinold Commodities Inc. [11]

Clayton Brokerage Co. [12]

Cargill Investor Services

ContiCommodities Services Inc. [13]

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[11] Filings with the Commission by Heinold Securities Inc., a broker-dealer registered with the Commission, lists Heinold Commodities Inc. as owner of 75-100% of its stock. Further, Dekalb AgResearch Inc., a Delaware Corporation, whose securities are registered with the Commission pursuant to Section 12 of the Exchange Act, owns 100% of Heinhold Commodities Inc.

[12] Filings with the Commission by Clayton Brokerage Co. of St. Louis, Inc., a broker-dealer registered with the Commission, lists Garnac Grain Co., Inc., as owner of 75-100% of its common stock.

[13] Filings with the Commission by ContiSecurities Inc., a broker-dealer registered with the Commission, lists ContiCommodity Service Inc. as owner of 75-100% of its stock.

We have endeavored to respond fully to your request. If the Subcommittee requires further data or has additional questions, the Commission is prepared to render further assistance.

Sincerely yours,

Philip A. Loomis, Jr.
Commissioner

Enclosures

5. A REPORT TO THE INTER-AGENCY TASK FORCE, "REGULATION OF SECURITIES CREDIT," DATED NOVEMBER 1979

REGULATION OF SECURITIES CREDIT
PURSUANT TO THE SECURITIES EXCHANGE ACT
OF 1934, AS AMENDED

A Report to the Inter-Agency Task Force

November, 1979

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Introduction

This paper provides a concise review of Federal Reserve margin regulations for use by the Inter-agency Task Force in its comparative study of the regulation of securities and commodities futures markets. The discussion begins with a review of the legal basis for federal regulation, proceeds with a description of the Federal Reserve Board's regulatory structure, and ends with a comparison of the leverage potential for securities and futures under existing regulation.

The paper discusses the extremely technical and legally complex margin credit regulations in a simplified fashion. It emphasizes a few important elements of the Board's regulatory structure and provides a framework for understanding Federal Reserve regulation of credit for securities transactions.

Legal and Economic Foundation

Legislative History

Although margins for securities and commodities futures transactions have usually been treated separately and distinctly, there have been occasions when they received joint attention. For instance, President Roosevelt referred jointly to securities and commodities at two separate places in his March 26, 1934 message to Congress in which restrictive margins were proposed to curtail speculation.

> "The people of this country...are, in overwhelming majority, fully aware of the fact that unregulated speculation in securities and in commodities was one of the most important contributing factors in the artificial and unwarranted 'boom' which had so much to do with the terrible conditions of the years following 1929."

> "I have been definitely committed to definite regulation of exchanges which deal in securities and commodities. In my message I stated, 'It should be our national policy to restrict, as far as possible, the use of these exchanges for purely speculative operations.'"

In general, however, securities and commodities have received separate regulatory attention both before and after 1934.

The first governmental regulation of the use of securities credit was imposed in an indirect way through the Federal Reserve Act of 1913. This regulation took the form of denying banks the opportunity to rediscount at Reserve Banks any notes, drafts or bills drawn for the purpose of purchasing, carrying, or trading in stocks or non-governmental bonds. Later, the Banking Act of 1933 (Glass-Steagall) authorized the Federal Reserve Board to suspend completely the rediscount privilege for any banks permitting undue use of credit for speculative trading in securities.

The Securities Exchange Act of 1934 (the Act), gave the Federal Reserve Board the authority and responsibility for the regulation of securities credit extended by various lenders. In section 7 of the Act, the Board was specifically charged with responsibility for "preventing the excessive use of credit for the purchase or carrying of securities." This section empowered the Board to prescribe rules to govern the amount of credit that an exchange member or a broker or dealer who transacted business through an exchange member could initially extend and subsequently maintain on any exchange-registered security. The Act contained an absolute prohibition against loans on the collateral of non-government securities that were not registered on exchanges.[1] The power to raise or lower any margin requirements applied to the initial extension or subsequent maintenance of credit was given exclusively to the Board, and in order to prevent circumvention of the rules applicable to the brokerage industry, the Board was given the power to impose similar lending restrictions on banks and other lenders.[2]

It was not only the "use of credit" narrowly defined as a transaction involving the actual passage of dollars from lenders to borrowers that Congress wanted to regulate, but more generally the degree to which securities purchasers or sellers could be leveraged by assuming a future or contingent liability. Thus, the Board was authorized to make special margin requirements for delayed deliveries, short sales, and arbitrage transactions. The Board has used this authority to set initial margin requirements for short sales of securities and for writing options.

Economic Considerations

In mandating federal regulation of securities credit Congress had in mind three goals:

(1) to protect investors from losses from speculation on credit,

(2) to prevent diversion of the nation's credit resources from productive use in trade and commerce into speculative activities in securities markets, and

(3) to inhibit excessive fluctuations in securities prices which stem from speculation on credit.

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[1] In 1968, Congress amended the 1934 Act to permit the purchase or carrying of certain over-the-counter stocks on margin at brokers or dealers. The specific OTC stocks eligible for margin lending were to be determined by the Federal Reserve Board.

[2] In 1971, Congress granted the Board additional authority to prevent circumvention of its securities credit regulations by expressly including borrowers within the strictures of the statute. As a result, securities purchases by U.S. residents financed by foreign lenders became subject to regulation.

All three reasons have guided the Board in the development of margin regulations. Over the years, however, protection of investors and inhibition of speculation on credit have received primary emphasis. The prevention of diversion of credit from productive uses became less important as total credit availability expanded from its depression low.

Regulatory Implementation

Administrative Flexibility

The Act allows the Board wide flexibility in its implementation of securities credit regulation. The original statutory formula, which the Board adopted in 1934 with Regulation T (applicable to lending by brokers or dealers), was very complex—allowing differential margins to be applied to stocks based upon their past price history. In 1936, when the Board adopted Regulation U (applicable to lending by banks on security collateral), a single flat rate for stocks became the standard and was made applicable to both banks and brokers.

The adoption of Regulation G in 1968 extended the Board's regulatory influence to lenders who are not banks or broker/dealers. Regulation X (applicable to all borrowing by or on behalf of any U.S. person, regardless of lender) was adopted in 1971 and was a regulatory response to the evasion possibilities posed by the increased internationalization of financial markets.

Regulatory policy is administered by the Federal Reserve Board through interpretation or amendment of Regulation T, U, G, and X or by alteration of the discretionary parameters—initial margin and retention requirements and requirements for inclusion on the list of OTC margin stock—of these regulations.[1/] The Board's discretionary power to set these requirements has made it possible to effect a policy shift quickly—that is, without having to go through the lengthy process of amending the regulations. During the 45 years of Federal Reserve margin regulation, the preferred policy instrument has been initial margin requirements, which have been changed 25 times.

Margin Requirements[1]

Percent of market value

Effective date	For credit extended under Regulations T (brokers and dealers), U (banks), G (lenders other than brokers, dealers, or banks), and X (borrowers)			
	Margin stocks	Convertible bonds	Short sales, T only	Writing options, T only[2]
10-01-34	25-45	....	(3)	....
2-01-36	25-55	....	(3)	....
4-01-36	55	....	(3)	....
11-01-37	40	....	50	....
2-05-45	50	....	50	....
7-05-45	75	....	75	....
1-21-46	100	....	100	....
2-01-47	75	....	75	....
3-30-49	50	....	50	....
1-17-51	75	....	75	....
2-20-53	50	....	50	....
1-04-55	60	....	60	....
4-23-55	70	....	70	....
1-16-58	50	....	50	....
8-05-58	70	....	70	....
10-16-58	90	....	90	....
7-28-60	70	....	70	....
7-10-62	50	....	50	....
11-06-63	70	....	70	....
3-11-68	70	50	70	....
6-08-68	80	60	80	....
5-06-70	65	50	65	....
12-06-71	55	50	55	....
11-24-72	65	50	65	....
1-03-74	50	50	50	....
1-01-77	50	50	50	30

[1] Regulations T, U, G, and X, adopted by the Board of Governors pursuant to the Securities Exchange Act of 1934, limit the amount of credit to purchase and carry "margin securities" and "margin stock" (as defined in the regulations) when such credit is collateralized by securities. Margin requirements are the difference between the market value (100 percent) and the maximum loan value of collateral as prescribed by the Board. Regulation T was adopted effective Oct. 15, 1934; Regulation U, effective May 1, 1936; Regulation G, effective Mar. 11, 1968; and Regulation X, effective Nov. 1, 1971.

[2] The margin is expressed as a percent of the current market value of the stock underlying the option.

[3] The requirement was the margin "customarily required" by the brokers and dealers.

[1/] Initial margin requirements for the purchase or carrying of securities and for short sales of securities are included in Supplements to Regulations T, U, and G. Also retention requirements limiting the withdrawal of collateral from margin accounts are specified in these same Supplements. The Supplements, in addition, contain the requirements for inclusion on the list of OTC margin stock, which is printed separately and updated semi-annually.

Initial margin requirements on stocks have ranged from a low of 25 percent in 1934 to a high of 100 percent in 1946. On four occasions, changes have been effected within three months of an earlier one—most recently in June of 1968. In contrast, current margin requirements essentially have been unchanged since January 3, 1974—the longest period between changes.[1/]

In addition to changing margin requirements, the Board can amend the regulations to achieve desired results. For example, the Board in the early days encountered practical problems relating to commodities and commodity margins when the accounts at broker/dealers carried positions in both securities and commodities. The original version of Regulation T required a debit entry for "the amount of any margin customarily required by the creditor on every future commitment in unissued securities, in commodities, or in foreign exchange..." No loan value could be assigned to a valuable commodity position, however, because the Act had an absolute prohibition against broker/ dealers lending for the purchase of securities on any collateral other than exchange-traded securities. After the passage of the Commodity Exchange Act in 1936, the Board amended Regulation T to provide a separate commodity account to which the broker/dealer must transfer all commodity positions and all funds

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[1/] A change involving adoption of the Board's uniform margin requirements for writing options, an amendment to Regulation T, took effect in January of 1977. This had no effect, however, on the level of margin applied to stocks or convertible bonds.

representing margin and mark-to-the-market debits and credits.[1]

Because of this separation of accounts, no problems have been observed regarding the handling of transactions in the special commodity account. Although customers are allowed to borrow on the excess collateral in any one account and deposit the funds in any other account, the concept of the special account prevents a person from using equity residing in one account as margin for transactions in another account. For example, margin deposits in a special commodity account cannot serve simultaneously as margin for futures and as initial margin for a stock purchase.

Although it has the power, the Board has chosen not to impose maintenance margins. Instead, lenders themselves are relied upon to require each margin borrower to maintain an adequate cushion of collateral in excess of the amount of indebtedness. Brokers, for example, must comply with maintenance margin standards imposed by the securities exchanges and the National Association of Securities Dealers, Inc. The Board's setting of initial margin requirements that are higher than these securities industry's maintenance standards creates a cushion against maintenance margin calls, which occur when price movements adversely a~~e~~ffect borrowers' securities positions.[1] Since initial margin requirements apply at the time of transactions, they are well suited to meet the Congressional intent of inhibiting excessive fluctuations in securities prices which stem from speculative purchases on credit.

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[1] The commodity account is one of 11 separate accounts established under Regulation T. The rule declares that all financial relations between a customer and a broker/dealer are part of his general account except for transactions eligible for one of the 10 separate special accounts. The other nine separate special accounts and the types of transactions affected and financed in each include the following:
Special arbitrage account—"bona fide" arbitrage across markets and securities.
Special bond account—exempt securities and margin non-equity securities.
Special cash account—full cash payment to be made within 7 days.
Special convertible bond account—debt securities convertible into margin stock.
Special insurance premium funding account—combined acquisition of investment company securities and insurance.
Special miscellaneous account—provision of loans to other brokers and segregation of withdrawable balances due customers.
Special omnibus account—transactions for other brokers representing aggregate positions of customers only.
Special subscription account—acquisition of a margin security through exercise of a warrant or right.
Specialist's account—trading which results from the discharge of the specialist's responsibilities.
Adequate records must be kept for each special account, transactions in any must be confined to those specifically authorized and each account must be treated as if there were no other accounts.

Distinctions by Types of Securities

The policy flexibility which Congress built into the 1934 legislation calling for regulation of securities credit extensions, gave the Federal Reserve Board considerable latitude in determing the amount of margin to be required for a given security purchase at various lenders--broker/dealers, banks, and other lenders. In general, the Board has followed a policy that strives for equal treatment for all lenders, except where statutory restrictions and other circumstances dictate otherwise. Broker/dealers, for example, are prohibited by the Act from lending unsecured or on any collateral other than margin securities, whereas banks and other lenders are in the business of making loans, some of which may be secured by margin stock, for purposes other than purchasing securities. Thus it would not be appropriate to apply margin requirements to all security-collateralized loans at banks and other lenders.

1/ Typically, brokerage firms enforce "house" margins which are more stringent than the NYSE's maintenance margin level calling for at least 25 percent customer equity. That is, a customer's indebtedness cannot exceed 75 percent of the value of the collateral on deposit with the broker under NYSE rules, but most brokers' "house" margins preclude indebtedness exceeding 70 percent.

With respect to loans-to-purchase securities the Board has determined that the wide variation in characteristics of different types of securities necessitates different initial margin requirements to meet the goals of the Act. The following brief descriptions of margin requirements by type of securities provide some idea of the distinctions that currently exist.

Equity: Common and preferred shares of stock traded on a national securities exchanged or included in the Federal Reserve Board's current List of OTC Margin Stocks are referred to as margin stock, the purchase or short sale of which necessitates meeting initial margin requirements (currently, 50 percent). In addition, exchange-listed warrants and rights evincing a claim on shares of equity are also considered margin stock and initial margin requirements (also, currently, 50 percent) apply to their purchase or short sale. Corporate equity securities not qualifying for margin must be paid for in full at brokers, although banks and other nonbank lenders can extend credit to purchase these securities.

Debt: Only convertible corporate bonds—owing to the potential for conversion into equity shares—are subject to specific Federal Reserve initial margin requirements (also, currently, 50 percent).[1] Borrowing to purchase most nonconvertible corporate bonds or government debt issues, however, is subject to "good faith" lending limitations at all lenders.[2] That is, lenders are free to determine prudent lending limits for the purchase or carrying of these debt securities. Similarly, short sales of government issues are not subject to federal margin requirements. However, short sales of corporate bonds must comply with the same initial margin requirements as apply to short sales of stocks.

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[1] Initial margin requirements on convertible bonds are currently the same as those for margin stocks (50 percent). This is coincidental and dates back to January 3, 1974 when margin stock requirements were lowered from 65 percent. The initial margin requirement on convertible bonds has usually been lower than that for stocks but higher than that customarily required by brokers on nonconvertible bonds.

[2] All exchange-listed and over-the-counter nonconvertible corporate bonds meeting Federal Reserve criteria are eligible for "good faith" lending treatment at all lenders. OTC bonds not meeting these criteria must be paid for in full at brokers, but may be purchased on credit at banks and other lenders.

Options: Options issued by the Options Clearing Corporation (OCC) are considered equity securities and are subject to margin regulation. A long position in either a call or a put option must be paid for in full. A short option position (that is, the position of an options writer) requires a margin deposit equal to 30 percent of the value of the underlying stock, marked-to-market, whenever an offsetting position in the same underlying stock or option is not maintained. Similar requirements apply to options that are unlisted and trade over the counter.

Speculation and Leverage

Comparison between Stocks and Options

The differences in treatment of securities under current margin regulations reflect, at least in part, differing susceptibility to speculation and different degrees of leveraging. Corporate bond purchases are not subject to an initial margin requirement because they are considered less susceptible to speculation than stock purchases, which are subject to initial margin requirements. However, short selling of corporate bonds is treated the same as short-selling of stocks—both are subject to initial margin requirements—because expectations regarding future price fluctuations motivate all short sales. Leverage differences also are reasons that margin requirements for the purchase or short sale of stock differ from the requirements applied to purchasing or writing (that is, short-selling) options.

Writing an option contract creates an obligation to perform in accordance with the terms of that contract.[1] As such the writer receives payment in the form of the option premium for assuming this contingent liability. Due to the nature of the commitment either to deliver stock to the call option holder or to accept delivery from the put option holder, a deposit to assure performance is in order. The performance obligations for an options writer—particularly, one writing call options—are very similar to those assumed by anyone making short sales of any security.

Margin requirements were amended, effective January 1, 1977, to specify that 30 percent of the value of stock underlying an option must be deposited as margin when offsetting positions in the underlying stock or other securities convertible into such underlying stock are not held by the option writer.[2] Essentially, this standardized margin requirements for options along the lines of established industry practice. The Board's inclusion of the rule in the margin regulations served primarily to codify existing procedures and precluded the emergence of different industry standards later. Also, it made violations of the standard a federal offense—subject to criminal prosecution and judicial review. By themselves, industry standards and rules do not have the force of law and often fail to provide fully for due process to settle disputes.

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[1] Options contracts, as traded on existing exchanges, have standardized terms regarding number of shares (100 per contract), expiration dates (fixed at three month intervals), and exercise price (at $5 intervals for exercise prices of $50 or less and at $10 intervals for exercise prices greater than $50). Both call options—granting the holder the right to buy shares and obligating the writer to sell shares at the stated exercise price—and put options—providing the holder with the right to sell shares and obligating the writer to buy shares at the stated exercise price—are now available on all options exchanges, although calls continue to dominate puts in terms of options series, trading, and open interest.

[2] In essence, the amendment made options writing subject to short sales margin requirements of one of the following types:

1. Fully Covered - offsetting position in underlying stock is maintained, and no additional margin is required.

2. Partially Covered - offsetting options position is held, and additional margin equal to the difference between the exercise prices of the written and the purchased options is required.

3. Uncovered - a margin deposit equal to 30 percent of the value of the stock underlying the options plus the amount represented by the difference between the market price of the stock and the exercise price of the option is required.

Margin regulations also stipulate that the purchase of options, either puts or calls, requires payment in full, and the options cannot be used as collateral to support any other margin transactions. This effectively provides for an initial margin requirement of 100 percent on the market value of an option purchase. The Board's requirements take into account the greater leverage potential afforded by options as compared to that provided by margin purchases of stock. Stock ownership to be sure, has some compensations not available to options holders, such as receipt of dividends and nonexpiration of ownership rights, but options retain substantial appeal as an alternative means to obtain an interest in stock price movements for a limited period of time. For example, a typical six-month call option with an exercise price equal to the current market price of the stock (that is, an "at-the-money" option) recently has been selling for about one-eighth as much as the shares of stock underlying that option contract. Simply stated, this suggests that currently the right provided by ownership of a six-month call option—namely, the opportunity to gain from price appreciation in the underlying stock for the next six months—can be purchased for about 1/8 of the amount required to own the stock outright.

An option's market value is determined by the sum of any value associated with immediate exercise ("intrinsic" value) plus any value accorded the time remaining until expiration ("time" value).[1] An option's value can reflect all "time" and no "intrinsic" value, as is the case with out-of-the-money options (for example, call options with an exercise price above the current market price of the shares represented). On the other hand, an option's value can be comprised of no "time" and all "intrinsic" value, as sometimes occurs just prior to expiration of a deeply in-the-money option (for example, call options with an exercise price well below the current market price for the stock). Normally, however, an option trades with both some "time" and some "intrinsic" value. But since an option is a wasting asset with a fixed expiration date, after which it is worthless, the "time" value of an option steadily erodes over its lifetime; only the "intrinsic" value remains at expiration.

The following illustration might help to clarify the above discussion of the relationship between options and stock investment returns.

An outlay of $4,000 buys:
$8,000 of XYZ stock on 50 percent margin
(100 shares @ $80 = $8,000) or

$4,000 of at-the-money call options on XYZ stock
(four 100-share contracts @ $1,000 = $4,000) 2/

If all transaction costs are ignored and any dividends on the stock are disregarded, an increase in stock value of $1,333.33 by expiration date of the option would make the returns from the two investments identical.

1/ The "time" value of a call option, for example, reflects the market assessment of the current value of the opportunity to profit from subsequent stock price advances, while not being exposed to loss from future stock price declines over the life of the call option contract.

2/ Each 100-share option contract is assumed to be valued at 1/8 of the amount required to own the related stock outright (1/8 x $8,000 = $1,000).

for stock investment:

$1,333.33 ÷ $4,000 original outlay = 33.3 percent return

for option investment:

each contract would be worth its intrinsic exercise value of $1,333.33

$1,333.33 x 4 contracts = $5,333.33
$5,333.33 - $4,000 original outlay = $1,333.33
$1,333.33 ÷ $4,000 original outlay = 33.3 percent return

In the above illustration, the rate of return to the option investment would be inferior to that of the stock investment for stock value increases of less than $1,333.33. For example, consider what a stock value gain of $1,325.00 (a $8.33 reduction of the increase for the previous illustration) implies for the rates of return to the similar dollar investments of the first example.

for stock investment:

$1,325 ÷ $4,000 original outlay = 33.1 percent return

for option investment

each contract would be worth its intrinsic exercise value of $1,325

$1,325 x 4 contracts = $5,300
$5,300 - $4,000 original outlay = $1,300
$1,300 ÷ $4,000 original outlay = 32.5 percent return

If, however, the stock value increase in the example exceeds $1,333.33, then an option investment would be superior to an investment in the related stock. An increase in stock value of $1,340.00 ($6.67 more than the breakeven case) would produce the following comparative rates of return.

for stock investment:

$1,340 ÷ $4,000 original outlay = 33.5 percent return for option investment:

$1,340 x 4 contracts = $5,360
$5,360 - $4,000 original outlay = $1,360
$1,360 ÷ $4,000 original outlay = 34.0 percent return

The three previous examples show that, under existing margin regulations, only an increase in stock value of 16.7 percent or more ($1,333.33 ÷ $8,000 = .1667 or less than 16.7 percent) would make an investment in options offer superior leverage potential to the purchase of the underlying shares on margin.

If options could be purchased on margin, though, the required increase to make investors indifferent between a margined position in the stock and one in the related option would be reduced accordingly. For example, allowing options to be purchased on the same percentage margin as stocks, currently 50 percent, would result in the lowering to less than 7.2 percent, the required increase in stock value to achieve indifference between stocks and options. This can be shown in terms of the earlier example.

$4,000 still buys, on margin, $8,000 of XYZ stock
(100 shares @ $80) or

$4,000 now buys, on margin, $8,000 of at-the-money call options
on XYZ stock (eight 100-share contracts @ $1,000)

But, with 50 percent initial margin requirements for both options and stock and again disregarding transaction costs and dividends, a stock value increase of about $571.43 would make the stock and option return identical.

for stock investment:

$571.43 ÷ $4,000 original outlay = 14.3 percent return

for option investment:

each contract would be worth its intrinsic exercise value
of $571.43

$571.43 x 8 contracts = $4,571.44
$4,571.44 - $4,000 original outlay = $571.44
$571.44 ÷ $4,000 original outlay = 14.3 percent return

As shown, the rates of return are essentially equivalent for a stock value gain of $571.43, which amounts to slightly less than 7.2 percent increase ($571.43 ÷ $8,000 original value of stock = .0714 or less than 7.2 percent).

Requiring that purchases of options be paid for in full, while allowing the underlying stocks to be bought on margin, represents a Federal Reserve policy decision to neutralize, to some degree, the speculative attractiveness of options as substitutes for stock market investment. Although it may be less than perfect, it runs in the direction of reducing the competitive leverage advantage enjoyed by options.

Comparison between Securities and Futures

In much the same way as options, futures contracts on shares of stock would offer investors the opportunity to obtain a highly leveraged claim to future price changes in the shares of stock represented. Disregarding the option premium, a futures buyer gains in the same way as a buyer of a call option and loses in the same way as a writer of a put option does, and a futures seller gains like a buyer of a put and loses like a writer of a call option does.

For stock price increases

Both futures buyers and call buyers gain as their contracts to purchase stock become more valuable assets,

both futures sellers and call writers lose as their contracts to sell become more costly liabilities, and

put buyers can lose no more and put writers can gain no more than the premiums paid for their contracts.

For stock price decreases

> Both futures buyers and put writers lose as their contracts to purchase become more costly liabilities,
>
> both futures sellers and put buyers gain as their contracts to purchase become more valuable assets, and
>
> call buyers can lose no more and call writers can gain no more than the premiums paid for their contracts.

The existence of the option premium, however, means that options writers (of both puts and calls) can offset losses to the extent of the premiums received. Futures buyers and sellers do not have such offsets available to them. The absence of premiums in commodities futures contracts is one of the principal distinctions between options and futures.[1]

The amount of funds required to establish a commodity futures position is determined by the respective exchanges and is called a margin requirement but actually serves as a partial payment for a commodity subject to future delivery. This sum is an assurance of performance by both the buyers and sellers of futures contracts. In contrast with a call option buyer who obtains a right to acquire stock for the payment of a premium, a futures buyer accepts an obligation to take future delivery unless and until the contract is closed. Due to the absence of premiums, futures contracts are more risky and offer greater leverage potential than options contracts.

The greater leverage of futures can be demonstrated by referring to the previous examples of rates of return to option and stock investment. In these, it was shown that options with a premium of 12.5 percent (1/8 of value of the underlying stock) required a 16.7 percent increase in stock value to equal the rate of return from investing directly in the stock on 50 percent margin. For the sake of easy comparison, an initial margin on futures contracts of 12.5 percent of the value of the stock represented by the contract is assumed.[1] Under these circumstances, the return from buying a futures contract would exceed the rate of return from buying the related stock for any increase in the price of that stock. The following comparison sharply distinguishes rates of return between stocks and futures for a $1 increase in stock value.

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[1] Another difference between options and futures relates to the timing of any delivery that might occur. Futures contracts have fixed delivery periods near the expiration of the contracts, whereas options can be exercised—and delivery necessitated—at any time during the life of the contracts.

XYZ Stock:

$8,001 - $8,000 stock value = $1 gain
50 percent initial margin required on original outlay of $4,000 (.5 x $8,000 = $4,000)

$1 ÷ $4,000 original outlay = .025 percent rate of return

Futures on XYZ Stock:

At an assumed 12.5 percent margin, each futures contract on $8,000 of stock would cost $1,000 (.125 x $8,000 = $1,000).

$4,000 original outlay ÷ $1,000 per contract = 4 contracts

A $1 increase in the amount of stock represented by a futures contract is reflected in a $1 increase in the value of each of the four futures contracts.

$1 x 4 contracts = $4 gain
$4 ÷ $4,000 original outlay = .1 percent rate of return.

For any increase in price of the related stock, a futures contract offers a superior return to a stock investment. Of course, since leverage cuts two ways, losses from any decrease in stock value are similarly magnified.

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[1] In fact, though, futures margins would normally be set much lower than 12.5 percent. Occasionally, however, they might be set much higher than 12.5 percent.

However, a decline in value of any stock need not necessarily result in losses for all investors carrying positions in stock. Just as short sellers of stock can profit from a price decline, so too can sellers of futures contracts. Furthermore, leverage is available to the same extent on the short side of the market as on the long side. That is, using the parameters of the previous example (50 percent margin on short sales of stocks and 12.5 percent margin on sales of futures), the sale of a futures offers four times as much leverage as a short sale of the same underlying stock.

Even with futures contracts subject to margin requirements equal to 12.5 percent, it has been shown that futures always offer greater leverage potential than a margined position in such stocks. With regard to options under these same circumstances, returns on futures would always exceed those associated with a like amount invested in options, because the required margin for futures serves as a downpayment for the stock not as a premium. As shown below, unless the overall gain in stock value exceeds the premium paid for the options, the rate of return to the holder of options can be negative.

In the context of the previous example, the generality of this point can be seen by looking at comparative rates of return for a $1 increase in XYZ stock value from $8,000 to $8,001.

Futures on XYZ stock:

At an assumed 12.5 percent margin, each long futures contract on $8,000 of stock would cost $1,000 (.125 x $8,000 = $1,000).

$4,000 original outlay ÷ $1,000 per contract = 4 contracts

A $1 increase in the amount of stock represented by a futures contract is reflected in a $1 increase in the value of each of the four futures contracts.

$1 x 4 contracts = $4 gain
$4 ÷ $4,000 original outlay = .1 percent return

Options on XYZ stock:

At an assumed 12.5 percent premium each call option contract on $8,000 of stock would cost $1,000 (.125 x $8,000 = $1,000).

$4,000 original outlay ÷ $1,000 per contract = 4 contracts.

A $1 increase in the amount of stock represented by a call option contract is reflected in a $1 increase in the value of each of the four call contracts.

$1 x 4 contracts = $4 gain

At expiration of an option, only the gain represents value

$4 - $4,000 original outlay = -$3,996
-$3,996 ÷ $4,000 original outlay = -99.9 percent return

Options contracts, as previously noted, do offer investors risk limiting features not present in futures contracts. The buyer of a call option, for example, can lose only the premium paid and no more; whereas, the buyer of a futures can lose an amount equal to the full exercise value of the contract.[1/] For speculators, however, the likelihood for large losses is offset by the equally likely possibility for large gains, and the choice may be made on the basis of funds required to acquire a position in futures as compared with options.

Even when the same amount of funds are required, as depicted in previous examples, futures offer more leverage than options. But, to the extent that futures margins are actually set at less than 12.5 percent, the leverage advantage of futures over options is increased. It is impossible to know whether the risk limiting features of options might prove valuable enough

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[1/] Of course, for a futures buyer to lose the entire value of a contract, the price of the related stock would have to fall to zero and the futures buyer would have to keep his futures position open throughout the drop in stock prices.

for options to compete effectively with futures, even with unequal leverage. This is something to be settled in the marketplace. It is clear, however, that margin requirements will strongly influence the final outcome, since low margins on futures mean high leverage and great speculative appeal for futures.

APPENDIX 4.—BANK LOAN DOCUMENTS

A. PARTNERSHIP COMMITMENT LETTER, DATED MAY 1, 1980

May 1, 1980

PARTNERSHIP COMMITMENT LETTER

Placid Oil Company
1600 First National Bank Building
Dallas, Texas 75202

Dear Sirs:

This letter will confirm the willingness of the undersigned, N. B. Hunt, W. H. Hunt and Lamar Hunt (the "Hunt Brothers"), to enter into a partnership with a wholly-owned subsidiary of Placid Oil Company ("Placid"), on substantially the terms and conditions hereinafter set forth:

1. Purpose: The purpose of the partnership is to provide a vehicle for the management and orderly disposition of the silver positions and other investments contributed to the partnership by the Hunt Brothers, on a basis which affords to Placid a satisfactory investment opportunity. The partnership will have the assistance and advice of qualified independent consultants.

2. Entity: The vehicle entity will be a Texas limited partnership (the "Partnership") whose general partner will be a wholly-owned, adequately capitalized subsidiary of Placid (the "General Partner") and whose sole limited partners will be the Hunt Brothers. (The General Partner and the Hunt Brothers are sometimes herein called the "Partners"). N. B. Hunt, W. H. Hunt and Lamar Hunt will have 59%, CAB [illegible] 40% and 01% CAB, respectively, of the total limited partners' interest, subject, however, to change by mutual agreement of the Hunt Brothers prior to formation of the Partnership.

3. Limited Partners' Contribution: The Hunt Brothers will contribute to the Partnership assets substantially as listed on Exhibit A (collectively called the "Contributed Assets", the Contributed Assets exclusive of the Coal Properties (described in paragraph 10) being called the "Investment Assets"), subject to but without any

assumption by the Partnership of debts substantially as listed on Exhibit A (the "Partnership Debt"). The Hunt Brothers shall be given credit for an equity investment in the Partnership in an amount currently estimated at $453,710,000.

The Hunt Brothers will also commit, jointly and severally, to make capital contributions in cash on the last business day of each February, May, August and November, beginning on February 27, 1981, in such amount as shall be required to permit distributions to the General Partner of the excess over the Stated Amount (hereinafter defined) of the sum of (a) the unpaid portion accrued through such date of the General Partner's 21% preferential return described in clause (1) of paragraph 5 below, and (b) an amount sufficient (after making the distributions required by clause (2) of paragraph 5) to reduce the General Partner's investment in the Partnership by an amount equal to the commitment reduction amount or quarterly installment of principal, as the case may be, due on such date (and due on any prior such date to the extent the General Partner's investment in the Partnership shall not have been reduced by such amount on such prior date) under the Revolving Credit Agreement referred to in paragraph 6 below; provided that aggregate contributions pursuant to this clause (b) shall in no event exceed 98% of the aggregate contributions of the General Partner to the capital of the Partnership. The "Stated Amount" shall be $100,000,000 to but not including the last business day of February 1982 and thereafter shall be reduced in accordance with the following table:

Stated Amount	Effective last Business Day of
$85,000,000	February 1982
$70,000,000	May 1982
$55,000,000	August 1982
$40,000,000	November 1982
$20,000,000	February 1983
-0-	May 1983

The Hunt Brothers will further commit, jointly and severally, to make additional capital contributions in cash, upon disposition by the Partnership of all of the Investment Assets, in such amount as shall be required to permit distributions to the General Partner of not less than 98% of its then unrecovered capital investment in the Partnership. All of the commitments of the Hunt Brothers contained in this paragraph 3 (the "Hunt Contribution Commitments") shall be secured by a second lien on the Hunt Collateral described in paragraph 7 below.

4. General Partner's Contribution:

A. The General Partner will make capital contributions in cash to the Partnership from time to time in an amount sufficient to enable it to discharge the Partnership Debt as required.

B. The Secured Note of the Hunt Brothers held by Placid, under which approximately $415,000,000 is currently outstanding, will be represented by two Notes in the respective unpaid principal amounts of approximately $265,000,000 and $150,000,000. The $265,000,000 Note will be contributed by the General Partner to the capital of the Partnership (for which the General Partner shall receive a capital contribution credit of $265,000,000), and since the Contributed Assets will be contributed subject to that debt, the transaction will cancel the debt. Placid will continue to hold the $150,000,000 Note, and may lend up to an additional $25,000,000 under such

Note to cover net losses or margin calls on the Silver Futures described below. Such Note (the "Hunt Brothers Note"), on which the Hunt Brothers will remain jointly and severally liable, shall bear interest at the rate of 21% and will be secured by (a) a third lien on the Hunt Collateral, (b) a first lien on the interest of the Hunt Brothers in the Partnership, and (c) a first lien on brokerage accounts in the names of one or more of the Hunt Brothers (but which accounts shall be controlled by Placid) containing all silver future positions (the "Silver Futures") presently held by the Hunt Brothers. Placid shall have complete power of attorney over the Silver Futures and all net proceeds derived from the sale thereof shall be applied in reduction of the Hunt Brothers Note.

5. Distributions: The intent of the Partners is that the Partnership generate sufficient cash flow in a commercially reasonable

manner to fund the following distributions. The net cash flow of the Partnership (from operations, sales of assets, liquidation, dissolution or termination of the Partnership, or otherwise) will be distributed in the following order of priority:

(1) 21% per annum preferential return to the General Partner on its unrecovered capital investment;

(2) 21% per annum preferential return to the Hunt Brothers on that portion of their unrecovered capital investment that is equal to the unpaid principal balance on the Hunt Brothers Note;

(3) Return of 98% of the General Partner's capital investment (upon complete return of which the Hunt Contribution Commitments and the collateral therefor shall be released);

(4) Return of the balance of the General Partner's capital investment;

(5) To the General Partner, amounts required in order to provide a 25.63% preferential return to the General Partner on its historical capital investment in the Partnership after consideration of the distributions to the General Partner under (1) and (3) above;

(6) 25% per annum preferential return to the Hunt Brothers on their unrecovered capital investment in excess of the sum of $294,000,000 and the Hunts' Coal Carry Contribution (defined in paragraph 10 below), less any amounts distributed pursuant to clause (2) above;

(7) Return of the Hunt Brothers' capital investment in excess of the sum of $294,000,000 and the Hunts' Coal Carry Contribution (defined in paragrah 10 below);

(8) Return of the Hunt Brothers' unrecovered capital investment, but only to the extent of any prior net

income from, or prior proceeds from the sale of, the Coal Properties described in paragraph 10;

(9) 50% of any additional proceeds will be distributed to the General Partner; and

(10) Remaining proceeds will be distributed to the Hunt Brothers.

6. Placid Financing: The obligations of Placid and the General Partner to enter into a definitive partnership agreement will be subject to Placid's entering into a Revolving Credit Agreement with a group of banks (the "Banks") on substantially the terms of the annexed Bank Commitment Letter, or such other terms as Placid and the Banks may agree upon. In order to induce the Banks to provide financing to Placid to enable Placid to fulfill its obligations to the Partnership, the Hunt Brothers will execute and deliver a joint and several guarantee of the due and punctual payment of the Banks' loans to Placid, such

guarantee to be secured by a lien on the Hunt Collateral, subject to no liens other than those existing liens heretofore disclosed to Placid and the Banks.

7. **Hunt Collateral:** The obligations of the Hunt Brothers with respect to (1) the guarantee of the Banks' loans to Placid, (2) the Hunt Contribution Commitments and (3) the Hunt Brothers Note, shall be secured in that order of priority by valid liens on (a) the remaining interest of the Hunt Brothers in the Beaufort Sea properties and (b) substantially all other assets owned by the Hunt Brothers aside from the Contributed Assets and the Silver Futures (collectively, the "Hunt Collateral"), which Hunt Collateral is summarized in Exhibit B.

The security documents will contain appropriate provisions for release of collateral, absent any defaults, in connection with (a) sales or other

dispositions of cattle, produce, hydrocarbons after severance and the like in the ordinary course of the operating businesses the assets of which are included in the Hunt Collateral, the proceeds from which may be retained and used in the ordinary course of business and for performance of the Hunt Brothers' obligations under the definitive partnership agreement and (b) a disposition of the amount required by law (currently, up to 35%) of the Beaufort Sea interests to Canadian purchasers, provided that the proceeds of such disposition shall be held in a special account in Canada monitored by Placid, and shall be disbursed only for Beaufort Sea exploration and development expenses in accordance with applicable Canadian regulations. Any other release of collateral shall be subject to the discretionary written consent of Banks holding 2/3 of the debt, the General Partner and Placid.

8. Conditions: The obligations of Placid and the General Partner to enter into a definitive partnership agreement shall be subject to the further conditions, among others, that:

A. The relationship of the Hunt Brothers to International Metals Investment Company Ltd. ("IMIC") and the exposure of W. H. and N. B. Hunt as guarantors of IMIC's debts to Merrill Lynch, Inc. shall have been resolved in the following manner: (i) the Hunt Brothers and/or the Partnership shall have arranged to purchase from IMIC, at a price equal to $14.05 per troy ounce, an amount of the silver collateral (excluding silver futures and related net open trade equity) securing IMIC's debt to Merrill Lynch equal to such debt, subject to such debt (except the portion of such debt secured by Treasury bills and silver futures and by related net open trade equity), and (ii) the Hunt Brothers shall have

obtained a release of their obligations under a certain pledge agreement with Merrill Lynch, and shall have obtained a release of any collateral (which released collateral shall be part of the Contributed Assets) pledged under such agreement.

B. There shall be furnished to Placid and the Banks an opinion, satisfactory in form and substance to Placid, of an independent investment banking firm of recognized standing as to a fair value to be given the silver contributed to the Partnership.

C. The conditions set out in this agreement and formation of the Partnersip as contemplated herein shall have occurred not later than May 31, 1980.

9. Covenants: **The limited partnership agreement and the guarantee of the Banks' loans shall include such representations, warranties, coverants, defaults and other provisions (including appropriate remedies for a breach of any of the**

foregoing) as Placid and/or the Banks may require consistent with the intent of this letter, including without limitation the following undertakings by the Hunt Brothers:

A. The Hunt Brothers will not, and will not permit any person, trust, or entity owned or controlled by them or any of them (a "Hunt Affiliate") to, and will use their best efforts to not permit any other trust or entity (a "Hunt Entity") of which them or any of them (or any of their descendants) is an officer, director, trustee, or beneficiary to make any new investment in securities (other than appropriate money market instruments) or take any position in commodities or any other position in commodities or any other futures position, for any speculative purpose or otherwise, except investments in commodities necessary for the prudent operation of the farm and ranching businesses included in the Hunt Collateral and the sugar

businesses owned by Hunt Affiliates and/or Hunt Entities.

B. The Hunt Brothers will not, and will not permit any entity or business within the Hunt Collateral, or for whose liabilities they (or any of them) or the Hunt Collateral may be liable, to enter into any commitment or guaranty which could require payment of a material amount of money except in the ordinary prudent course of operating any such businesses or entities.

C. W. H. Hunt and N. B. Hunt will take all possible steps consistent with applicable law in order that IMIC (i) will manage and dispose of in an orderly manner its silver position and (ii) take no new commodities positions which result in a net increase in such positions.

D. The Hunt Brothers will not, and will not permit any Hunt Affiliate to, and will use their best efforts to not permit any Hunt Entity (other than

IMIC) to, guarantee or pledge any assets to secure any obligations of IMIC.

10. Coal Properties: In addition to the Investment Assets, the Hunt Brothers will contribute to the Partnership certain coal properties in Montana and North Dakota (the "Coal Properties") which properties have an aggregate appraised value of approximately $294,000,000. The Hunt Brothers shall be given credit for an equity investment in the Partnership in such amount. The Hunt Brothers shall make additional capital contributions ("Hunts' Coal Carry Contribution") to the Partnership to the extent necessary to fund the carrying costs of the Coal Properties; provided, however, that following the time ("Option Time") that the Partnership has distributed all amounts required in clauses (1) through (6) of paragraph 5 above, such carrying costs shall be contributed 50% by the General Partner and 50% by the Hunt

Brothers. Notwithstanding the distribution priorities established in paragraph 5, the first 33 1/3% of the proceeds of any sale of the Coal Properties, but not in excess of $100,000,000, shall be distributed to the Hunt Brothers as a return of their capital contribution pursuant to clause (8) of paragraph 5. Such distribution shall be used by the Hunt Brothers to pay any income taxes resulting from such sale and any excess shall be applied to payment of the Hunt Brothers Note. Any additional proceeds derived from a sale of the Coal Properties shall be distributed in accordance with the priorities set forth in paragraph 5 hereof. Costs of development of the Coal Properties shall be borne 50% by the Hunt Brothers and 50% by Placid; provided, however, that no development of the Coal Properties shall be commenced by the Partnership prior to the Option Time. At any time following the

Option Time, if the Coal Properties are then owned by the Partnership, the General Partner may cause the Coal Properties to be distributed to the Hunt Brothers as a return of their capital contribution pursuant to clause (8) of paragraph 5, such distribution to result in a debit to the capital of the Hunt Brothers in the amount of $294,000,000; and following such distribution neither the General Partner nor the Partnership shall have any interest in or obligation with respect to the Coal Properties.

11. General: A. All other terms and all documentation in connection with the transactions contemplated hereby to be in form and substance satisfactory to Placid, the Banks and the Hunt Brothers and their respective counsel.

B. Costs and expenses of Placid in connection with the transactions contemplated hereby to be borne by the Hunt Brothers.

If the foregoing is acceptable to you, please so indicate so that comprehensive definitive documentation with respect to the transactions contemplated hereby may be prepared.

/s/ N.B. Hunt
N. B. Hunt

/s/ W.H. Hunt
W. H. Hunt

/s/ Lamar Hunt
Lamar Hunt

Accepted and agreed to:

PLACID OIL COMPANY

By CW Brown

Exhibit A

Estimated Summary of Assets to be Contributed to Partnership

April 1980
(Thousands of Dollars)

	Estimated Value*	Outstanding Debt	Equity
N. B. Hunt			
Coal Properties	147,000	-	147,000
Coins and Bullion	9,035	-	9,035
Silver Coins and Bullion (Citibank)	31,562	17,500	14,062
Gold Coins (Schroder)	2,687	367	2,320
Bullion (ACLI)	100,246	59,905	40,341
Bullion and Coins (Swiss Bank)	116,356	82,298	34,058
Forward Contracts	73,550	73,550	-
Forward Contract Cash Deposit	93,127	91,757	1,370
London Bullion Unpledged	422	-	422
Broker Margin Accounts	135,013	25,811	109,202
Accrued Interest	-	1,394	-
	708,998	352,582	356,416
Debt to Placid	-	156,350	(156,350)
	708,998	508,932	200,066
W. H. Hunt			
Coal Properties	147,000	-	147,000
Coins and Bullion	3,901	-	3,901
Silver Coins and Bullion (Citibank)	31,562	17,500	14,062
Bullion and Coins (Swiss Bank)	134,563	95,143	39,420
Bullion (ACLI)	54,528	29,353	25,175
Broker Margin Accounts	105,689	12,665	93,024
Forward Contracts	57,996	57,996	-
Forward Contract on Cash Deposit	64,363	64,363	-
Bullion (Merrill Lynch)	115,393	75,778	39,615
Accrued Interest	-	1,273	1,273
	716,365	354,071	362,294
Debt to Placid		108,650	(108,650)
	716,365	462,721	253,644
International Metals Investment Company Ltd. (IMIC)			
Silver Coins, Leases, Bullion (11,174,370 oz.)	157,000	157,000	-
	157,000	157,000	-
	1,582,363	1,128,653	453,710

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* Silver valued at $14.05/oz.; gold and securities at 4/25/80 market values.

Exhibit B

N. B. HUNT, W. H. HUNT AND LAMAR HUNT

Summary of Estimated Collateral

April 1980
(Thousands of Dollars)

Assets	Estimated Collateral Value	Outstanding Debt	Placid Equity
N. B. Hunt			
Oil and gas and geothermal properties	24,154		
Real estate	43,854		
Ranch plant and equipment	9,728		
Notes receivable	43,395		
Ranch cattle	31,646		
Race horses	116,209		
Coin and art collection	34,000		
Securities	52,719		
Partnerships	854		
Beaufort Sea oil and gas property	1,135,000		
	1,491,559		1,491,559
First National Bank in Dallas	82,981	52,665	30,316
Continental Illinois	6,385	4,153	2,232
	1,580,925	56,818	1,524,107
W. H. Hunt			
Oil and gas and geothermal properties	1,430		
Real estate	5,528		
Accounts and notes receivable	26,324		
Securities	2,931		
Coin and art collection	9,500		
Partnerships	20,564		
Beaufort Sea oil and gas property	567,500		
	633,777		633,777
First National Bank in Dallas	28,082	22,180	5,902
	661,859	22,180	639,679
Lamar Hunt			
Undeveloped leases	1,359		
Real estate	2,051		
Art collection	4,000		
Balance due on sale of HIPCO-UK	3,625		
Securities	1,777		
Partnerships	364		
Beaufort Sea oil and gas property	567,500		
	580,676		580,676
First National Bank in Dallas	21,176	14,807	6,369
	601,852	14,807	587,045
	2,844,636	93,805	2,750,831

BANK COMMITMENT LETTER

May 1, 1980

Placid Oil Company
1600 First National Bank Building
Dallas, Texas 75202

Gentlemen:

Subject to the conditions herein stated, the undersigned banks are willing to make loans to Placid Oil Company upon the following terms:

Borrower: Placid Oil Company ("Placid").

Agents: First National Bank in Dallas ("First in Dallas") and Morgan Guaranty Trust Company of New York ("Morgan").

Amount: $1,100,000,000

Lenders:

Bank	Amount
First in Dallas	$ 10,000,000
Morgan	$ 100,000,000
Citibank, N.A.	$ 200,000,000
The Chase Manhattan Bank (National Association)	$ 150,000,000
Bank of America National Trust and Savings Association	$ 100,000,000
Manufacturers Hanover Trust Company	$ 100,000,000

Continental Illinois National Bank and Trust Company of Chicago	**$**	**80,000,000**
Canadian Imperial Bank of Commerce	**$**	**75,000,000**
The Royal Bank of Canada	**$**	**75,000,000**
The First National Bank of Chicago	**$**	**70,000,000**
Chemical Bank	**$**	**50,000,000**
Bankers Trust Company	**$**	**50,000,000**
Republic National Bank of Dallas	**$**	**40,000,000**

Purposes: Proceeds of the loans will be used by Placid to enable it to fund the obligations of a Placid subsidiary in a Partnership (herein so called) to be formed between the subsidiary, as General Partner, and Nelson Bunker Hunt, William Herbert Hunt, and Lamar Hunt (the "Hunt Brothers"), as Limited Partners, upon the terms and conditions stated in a letter agreement (the "Partnership Commitment Letter") between Placid and the Hunt Brothers substantially in the form attached hereto, to renew certain interim advances by certain of the lenders, and for such other general corporate purposes as Placid may deem appropriate.

Drawdown: Reducing revolver through May 31, 1983, with mandatory reductions in commitment as follows:

(a) The applicable Commitment Reduction Amount set forth in the annexed Schedule, on the last business day of each February, May, August and November in each year commencing November 30, 1980; and

(b) Amount of mandatory prepayments (with, until the Cash Flow Maintenance Tests are first met, partial credit to future scheduled reductions, in the case of mandatory prepayments pursuant to clauses (a) and (b) under Mandatory Prepayments, so as to achieve ratable application over the full life

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of the loan).

Repayment: Quarterly installments over a seven-and-one-half-year period on the last business day of each May, August, November and February in each year commencing August 31, 1983, in an amount equal to the applicable Amortization Percentage (set forth in the annexed Schedule) of the unpaid balance on May 31, 1983.

Mandatory Prepayments:

(a) Distributions from the Partnership to the General Partner;

(b) All payments received on the Hunt Brothers Note described in the Partnership Commitment Letter; and

(c) Proceeds of sales of collateral (to be shared ratably with 1979 Lenders in the case of collateral described in clause (a) of Collateral).

Optional Prepayments: Permitted at any time without penalty, in minimum amounts of $5,000,000.

Application of Prepayments on Term Loan:

(a) Optional prepayments applied ratably to installments.

(b) Mandatory prepayments applied to installments in inverse order of maturity.

Interest: Payable on the last business day of each February, May, August and November at a rate equal to

(a) until April 9, 1983, 103% of (Alternate Base plus 1/2%); and

(b) thereafter, 105% of (Alternate Base plus 1/2%).

Alternate Base will be defined as the greater of Adjusted Reserve Effective CD Rate plus 1/2% or Morgan Prime.

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Fees:

(a) Commitment fee of 1/2% on unused portion commencing April 28, 1980.

(b) Fee in lieu of balances commencing April 28, 1980 equal to (i) until May 31, 1983, 5% of (Alternate Base X total commitments) and (ii) thereafter, 5% of (Alternate Base X outstanding principal balance).

(c) Demand note lenders to receive accrued commitment fees and fees in lieu of balances from April 9, 1980 on $800,000,000 total commitments (commitment fee net of $300,000,000 outstanding).

Collateral: (a) To be shared ratably with 1979 Lenders:

(i) All interests of Placid and subsidiaries in all engineered properties, including without limitation L/10-11 field in North Sea and Black Lake Field in Louisiana;

(ii) Refineries and related pipeline systems;

(iii) Pipeline system involved in present acquisition discussions;

(iv) DSM Note;

(v) Stock of all Placid subsidiaries (except stock of General Partner); and

(vi) Such other collateral as Majority Banks may require from time to time.

(b) To secure this debt only:

(i) Rights of General Partner under the Partnership Agreement contemplated by the Partnership Commitment Letter;

(ii) All assets of the Hunt Brothers securing the Hunt Brothers Guaranty contemplated by the Partnership Commitment Letter;

(iii) Stock of General Partner; and

(iv) Hunt Brothers Note.

Guarantors:

(a) All Placid subsidiaries requested by lenders; and

(b) The Hunt Brothers Guaranty contemplated by the Partnership Commitment Letter. The Hunt Brothers Guaranty shall include joint and several indemnities of the Hunt Brothers from any claims arising out of the contemplated transactions.

Representations and Warranties: Usual and customary, and such other representations and warranties as lenders may request. Lenders shall receive such information and certifications as they request to satisfy themselves as to the accuracy of all representations and warranties, including those made by the Hunt Brothers in the Partnership Agreement and the Hunt Brothers Guaranty.

Closing Conditions: Usual and customary, including:

(a) Satisfaction of the conditions and requirements stated in the Partnership Commitment Letter and in the definitive Partnership Agreement.

(b) Consummation of the settlement of the claims of Engelhard Minerals and Chemicals Corporation against the Hunt Brothers on a basis satisfactory to lenders.

(c) Satisfactory resolution of the IMIC relationship upon the terms stated in the Partnership Commitment Letter.

(d) Satisfaction with respect to state of title to, and perfection of liens on, major Placid properties and major properties of the Hunt Brothers.

(e) Consents of the adult beneficiaries (vested and contingent) and their spouses, trustees and advisory board members of the trusts (the "1935 trusts") which own the stock of Placid to the contemplated transactions.

(f) Satisfaction with respect to any material litigation or governmental proceedings pending or threatened against any of the Hunt Brothers or any Hunt Affiliate or Hunt

Entity (as defined in the Partnership Commitment Letter).

(g) Several indemnities of Margaret Hunt Hill and Caroline Hunt Schoellkopf from any claims by any of their respective descendants and from any person who may take from Haroldson L. Hunt, Jr.

(h) Several indemnities from each other adult beneficiary from any claims of any person who may take from him.

(i) Necessary waivers from other lenders.

(j) Other appropriate conditions and legal opinions.

Covenants (Placid Loan Agreement) (applicable to Placid, Subsidiaries and the Partnership):

(a) Financial statements:

(i) Audited annually; and

(ii) Unaudited quarterly.

(b) (i) Engineering reports and reviews annually, and (ii) cash flow reports quarterly, with all lenders having right to comment on assumptions and 51% of lenders having right to approve assumptions.

(c) Other information requested by lenders.

(d) Quarterly certificates of no default by officer of Placid and annual certificate of no default by independent accountants.

(e) No liquidations or dissolutions except into Borrower or Placid International Oil Ltd. ("PIOL").

(f) No mergers or sales of all or substantially all assets other than mergers if (i) no default will occur, and (ii) Placid, PIOL, or a guarantor subsidiary is the survivor. No mergers or sales of substantial assets by, with or to General Partner.

(g) No sales of collateral other than (i) hydrocarbons after severance in ordinary course, (ii) refined products in ordinary course and (iii) surplus equipment in ordinary course.

(h) Proceeds of sales of assets by Partnership distributable to the General Partner shall be applied as prepayments on this debt.

(i) No debt, except:

(i) This debt;

(ii) The debt ("1979 Debt") under the $450,000,000 Amended and Restated Loan Agreement among Placid and PIOL, as Borrowers, and 20 banks (the "1979 Lenders") including Agents, as lenders (such loan agreement and the contemplated new loan agreement, the proceeds from which will be used to discharge such debt, being herein called the "1979 Loan Agreement");

(iii) Other existing debt;

(iv) Intercompany debt;

(v) Additional pipeline debt not exceeding $30,000,000 representing purchase money debt in connection with a proposed acquisition of a gas gathering system in Louisiana;

(vi) After the Cash Flow Maintenance Tests are first met, Nonrecourse Secured Debt similar to that permitted under the 1979 Agreement as presently in effect; and

(vii) After the Cash Flow Maintenance Tests are first met, additional debt of Placid (but not any subsidiary), if, after giving effect thereto, the Cash Flow Maintenance Tests will be met.

(j) Cash Flow Maintenance Test (to become effective on May 31, 1983, or when first met, if earlier):

(i) Cash Flow from Engineered Properties for the life of such properties must equal or exceed 166% of Total Required Debt Service; and

(ii) Consolidated Cash Flow from All Operations in next 12 months must equal or exceed 125% of

Annual Required Debt Service.

This test, once effective, is required to be met prospectively for each year for the remaining term of the loans.

(k) Maintain, at all times prior to effectiveness of Cash Flow Maintenance Tests, Consolidated Cash Flow from All Operations in next 12 months equal to or exceeding 105% of Annual Required Debt Service.

(l) No liens except:

(i) Immaterial liens presently permitted;

(ii) Liens securing this debt and the 1979 Debt;

(iii) Liens on margin stock to secure existing margin debt;

(iv) Existing liens;

(v) Liens on the gas gathering system referred to in (i)(v) preceding to secure the debt referred to therein; and

(vi) Liens securing Nonrecourse Secured Debt permitted by (i)(vi) preceding.

(m) No dividends or distributions (other than distributions by the Partnership required under the Partnership Commitment Letter), or investments in Insiders, until Cash Flow Maintenance Tests are met, and thereafter only if (i) no default will exist and (ii) noncumulative dividends, distributions and investments during the year in question do not exceed 15% of consolidated net income after taxes for the preceding year.

(n) No acquisitions or investments other than (i) investments in the Partnership, not to exceed $1,100,000,000, (ii) other intercompany advances, (iii) the pipeline acquisition referred to in (i)(v) for a purchase price not exceeding $40,000,000, (iv) short-term money market investments, (v) payment of the $20,000,000 balance of the purchase price of HIPCO (UK), (vi) ordinary and necessary expenditures in connection with refining operations, lease acquisition and exploration and development activities, (vii) loans of up to

$25,000,000 to the Hunt Brothers as contemplated by the Partnership Commitment Letter, and (viii) others not exceeding $1,000,000 per year (noncumulative).

(o) Cause the General Partner to perform its obligations, and to require performance by Hunt Brothers of their obligations, under Partnership Agreement, and to enforce its rights thereunder.

(p) No amendments of or waivers under Partnership Agreement.

(q) No release of collateral securing additional contribution obligations of Hunt Brothers under Partnership Agreement or the Hunt Brothers Note unless (i) proceeds are used to retire this debt or (ii) Placid and Majority Banks have agreed to allow Hunt Brothers to retain proceeds, except as set forth in the Partnership Commitment Letter. Any sale of collateral permitted by such release shall be on arm's-length terms.

(r) No issuance of additional stock by subsidiaries.

(s) No optional prepayments on 1979 Debt unless ratable optional prepayments are made on this debt.

(t) No sales to or purchases from affiliates.

(u) Lease rental obligations (other than hydrocarbon leases, drilling rig leases and leases of office space) not to exceed 5% of debt permitted under (i)(i), (i)(ii), (i)(iii) and (i)(vii).

(v) As soon as feasible, Placid and PIOL to enter into new $450,000,000 agreement with amortization similar to the present 1979 Agreement and other terms (other than those relating to the Partnership and Hunt Brothers) similar to the credit agreement related to this debt.

(w) General Partner to engage in no business except as contemplated by the Partnership Agreement.

(x) Other usual and customary covenants.

Covenants (by Hunt Brothers under Guaranty): Restrictions on investment activities and liability creation similar to restrictions contemplated by the Partnership Commitment Letter and covenant not to become officers or directors of Placid.

Default: Usual and customary, including default if any of the Hunt Brothers shall become an officer or director of Placid.

Waiver and Amendments: Requires lenders holding 2/3 of debt ("Majority Banks").

Legal Expenses: Payable by Placid, whether or not credit agreement is executed, including fees and expenses of counsel for each Agent and special counsel for lenders.

Credit Agreement and Other Documentation: The commitment of the undersigned is subject to negotiation and execution of a credit agreement, a closing agreement and security documentation in form and substance satisfactory to lenders and their counsel.

Governing Law: New York.

If the foregoing is acceptable to you, please so indicate by executing and delivering a counterpart hereof so that comprehensive definitive documentation for this credit facility may be prepared. This agreement will terminate and expire unless the various conditions and requirements herein have been satisfied by Placid or waived by all lenders on or before 2:00 P.M., New York time, on May 31, 1980.

FIRST NATIONAL BANK IN DALLAS,
as Lender and as Agent

By:__________________________

MORGAN GUARANTY TRUST COMPANY
OF NEW YORK, as Lender and
as Agent

By:__________________________

CITIBANK, N.A.

By:__________________________

THE CHASE MANHATTAN BANK
(NATIONAL ASSOCIATION)

By:__________________________

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION

By: ______________________

CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO

By: ______________________

THE ROYAL BANK OF CANADA

By: ______________________

BANKERS TRUST COMPANY

By: ______________________

REPUBLIC NATIONAL BANK OF DALLAS

By: ______________________

MANUFACTURERS HANOVER TRUST COMPANY

By: ______________________

CANADIAN IMPERIAL BANK OF COMMERCE

By: ______________________

THE FIRST NATIONAL BANK OF CHICAGO

By: ______________________

CHEMICAL BANK

By: ______________________

Accepted and agreed to:

PLACID OIL COMPANY

By: ______________________

Date: ______________________

Placid Oil Company
Amortization Schedule

	Commitment Reduction Amount	Commitment at End of Period (beginning amount $1.1 billion)
Nov. 80	6.0	1094
Feb. 81	16.5	1077.5
May 81	16.5	1061.0
Aug. 81	16.5	1044.5
Nov. 81	16.5	1028.0
Feb. 82	20.0	1008.0
May 82	20.0	988.0
Aug. 82	20.0	968.0
Nov. 82	20.0	948.0
Feb. 83	20.25	927.75
May 83	20.25	907.50

Converts to term

				Amortization Percentage (amortization per quarter as % of amount of beginning term loan)
Q12-17	6q.	20.25	786.0	2.231%
18-21	4q.	30.5	664.0	3.361%
22-25	4q.	32.25	535.0	3.554%
26-29	4q.	33.75	400.0	3.719%
30-33	4q.	36.0	256.0	3.967%
34-37	4q.	43.75	81.0	4.821%
38-40	3q.	20.25	20.25	2.231%
final	1q.	20.25	0	2.231%

B. REVOLVING CREDIT AGREEMENT AMONG PLACID OIL COMPANY, FIRST NATIONAL BANK IN DALLAS AND THIRTEEN BANKS, DATED APRIL 26, 1980

EXECUTION FORM

REVOLVING CREDIT AGREEMENT

among

PLACID OIL COMPANY
as Borrower

FIRST NATIONAL BANK IN DALLAS and
MORGAN GUARANTY TRUST COMPANY OF NEW YORK
as Agents

and

THIRTEEN BANKS
as Lenders

* * *

$1,100,000,000

* * *

April 26, 1980

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REVOLVING CREDIT AGREEMENT

THIS AGREEMENT, dated as of April 28, 1980, is entered into among PLACID OIL COMPANY ("Borrower"), FIRST NATIONAL BANK IN DALLAS and MORGAN GUARANTY TRUST COMPANY OF NEW YORK, as Agents ("Agents"), and the banks (including Agents) named in Schedule One (the "Banks").

WITNESSETH:

In consideration of the mutual promises contained herein and other valuable consideration, the receipt and adequacy of which are hereby acknowledged, the parties hereto hereby agree as follows:

SECTION 1. Definitions. Section 9 contains definitions of certain terms used in the Loan Papers.

SECTION 2. Representations and Warranties. Borrower, and each Subsidiary executing and delivering a Guaranty, jointly and severally represent and warrant that the representations and warranties made in each Closing Certificate will be true and correct in all respects as of the date thereof.

SECTION 3. Loans.

3.1 Commitments.

(a) Revolving Credit Loans. Subject to the terms and conditions set forth in the Loan Papers, each Bank severally agrees to make its Pro Rata Part of Loans (the "Loans") to Borrower during the period from the date hereof to and including May 31, 1983 (the "Termination Date"), which Borrower may repay and reborrow from time to time on or prior to the Termination Date in accordance with the terms hereof; provided that (a) the Total Principal Debt shall never exceed the Total Committed Sum; (b) each Bank shall have an obligation only to make its Pro Rata Part of each Loan; (c) the Principal Debt for any Bank shall never exceed such Bank's Pro Rata Part of the Total Committed Sum; and (d) each Loan must be in the amount of at least $5,000,000. Each Bank's portion of the initial Total Committed Sum is stated on Schedule One. The Total Committed Sum shall initially be

$1,100,000,000, subject to reduction in accordance with Section 3.1(b) below.

(b) Mandatory Reduction of Commitments. (i) On each Commitment Reduction Date, the Total Committed Sum shall be reduced by the applicable Commitment Reduction Amount (herein so called) set forth in Schedule Two (as the same may have been reduced pursuant to Section 3.1(c)).

(ii) On the date of any mandatory prepayment pursuant to Section 6.3 or 6.8(d), the Total Committed Sum shall be reduced by the amount of such prepayment.

(iii) Except as set forth in Section 3.1(c), the foregoing mandatory reductions of the Total Committed Sum shall be cumulative, and none shall reduce the amount of any other mandatory reduction.

(c) Credit Towards Commitment Reduction Amounts. Until the Cash Flow Maintenance Tests are first met, upon any mandatory reduction of the Total Committed Sum by reason of a mandatory prepayment pursuant to Section 6.8(d) (but not Section 6.3), the amount of such mandatory reduction shall be applied (in forward chronological order) to reduce the Commitment Reduction Amounts applicable to the four Commitment Reduction Dates next succeeding the date of such mandatory reduction pursuant to Section 6.8(d) (including, as the first such succeeding Commitment Reduction Date, the date of such mandatory reduction if such date is a Commitment Reduction Date). If by application of this Section 3.1(c), the Commitment Reduction Amounts applicable to the four Commitment Reduction Dates next succeeding the date of any such mandatory reduction shall have been or be reduced to zero, no additional or subsequent credit shall be available with respect to such mandatory reduction.

3.2 Method of Making Loans. Borrower shall give Agents not less than three Business Days' notice of each Loan, and Agents shall promptly notify each Bank of the date and amount of such Loan and such Bank's Pro Rata Part thereof. Each Bank shall remit, prior to 11:00 a.m. (New York time) on the date of each Loan its Pro Rata Part of the Loan in Immediately Available Funds, to the account of Morgan in New York City, in favor of Borrower, or such other account as Morgan may designate in such notice. Subject to receipt of such funds, Morgan (unless to its actual knowledge any of the conditions precedent have not been satisfied by Borrower or waived by Majority Banks (or, in the case of the initial Loan, by all Banks)) shall make such funds available to Borrower by causing such funds to be remitted to First in Dallas in Immediately Available Funds, to be credited to the account of Borrower at First in Dallas, in Dallas, Texas.

3.3 Notes. Borrower's obligations to repay the Loans shall be evidenced by Notes executed by Borrower, in the form of Exhibit D, one payable to the order of each Bank, in (i) the amount stated opposite the name of such Bank on Schedule One, or (ii) such Bank's Pro Rata Part of the Total Principal Debt, whichever is less. Each Note shall have the blanks therein appropriately completed in accordance with the provisions of this agreement and shall bear interest as provided in Section 3.5.

3.4 Repayment of Notes. Subject to the provisions of the Loan Papers as to optional and mandatory prepayments, the principal of the Notes shall be payable in 29 consecutive quarterly installments, commencing on the last Business Day of August 1983, and on the last Business Day of each August, November, February, and May thereafter, to and including the last Business Day of August 1990, and a 30th and final installment on November 30, 1990, in the amount of the entire unpaid balance of principal of the Notes. Each of the first 29 quarterly installments payable on all Notes in the aggregate shall be equal to the product of (a) the applicable Amortization Percentage (herein so called) set forth in Schedule Two times (b) the Total Principal Debt at the close of business on the Termination Date.

3.5 Interest on Notes. The unpaid Principal Debt from time to time outstanding shall bear interest at the rates set forth below:

(a) Interest Rate prior to Maturity. Each Note shall bear interest prior to maturity at a rate per annum equal to the lesser of (i) the Highest Lawful Rate or (ii) the Applicable Rate. Interest shall be payable quarterly on the last Business Day of each February, May, August, and November.

(b) Overdue Principal and Interest. If any principal of or interest on any of the Notes is not paid in accordance with the provisions of the Loan Papers, such overdue principal and, to the extent permitted by Law, overdue interest shall bear interest from the due date (stated or by acceleration), payable on demand, until paid at a rate per annum equal to the lesser of (i) the Highest Lawful Rate or (ii) the sum of 2% plus 105% of the sum of the Alternate Base Rate plus one half of one percent (1/2%).

(c) Continuance of Interest at Highest Lawful Rate. If at any time and from time to time the rate of interest calculated pursuant to Section 3.5(a)(ii) or 3.5(b)(ii) would exceed the Highest Lawful Rate thereby causing the interest payable on the Notes to be limited to the Highest Lawful Rate as provided in Sections 3.5(a)(i) and 3.5(b)(i), then any subsequent reduction in the rate specified in Section 3.5(a)(ii) or 3.5(b)(ii) shall not reduce the rate of interest payable on the Notes below the Highest Lawful Rate until the total amount of interest accrued on the Notes from and after the First Closing Date equals the amount of interest which would have accrued thereon if the rate specified in Section 3.5(a)(ii) or 3.5(b)(ii), as the case may be, had at all times been in effect.

(d) Computation of Interest. Interest on the Notes and the fees payable pursuant to Section 4 shall be calculated on the basis of actual days elapsed and computed as if each year consisted of 360 days, except during any periods when the Notes are bearing interest at the Highest Lawful Rate, during which periods such interest and fees shall be computed on the basis of the actual number of days in the years in question.

3.6 Prepayment of Notes.

(a) Optional. Borrower may, upon not less than three Business Days' prior notice to Agents, prepay the Total Principal Debt, without penalty, at any time in whole or from time to time in part, in amounts of at least $5,000,000. Simultaneously with any such optional prepayment which is made after the Termination Date, Borrower shall prepay in accordance with the 1979 Loan Agreement a portion of the 1979 Principal Debt in an amount which bears the same proportion to the 1979 Principal Debt as the amount to be prepaid hereunder bears to the Total Principal Debt. Optional prepayments after the Termination Date shall be applied ratably (by amount, not number) to all remaining installments of principal on the Notes.

(b) Mandatory. (i) Borrower shall make the mandatory prepayments required by Sections 6.3 and 6.8(d).

(ii) If at any time on or prior to the Termination Date, the Total Principal Debt exceeds the Total Committed Sum, Borrower shall immediately make such payment as may be necessary to eliminate such excess.

(iii) All mandatory prepayments after the Termination Date shall be applied to installments of principal on the Notes in inverse order of maturity.

(c) Accrued Interest. Each mandatory or optional prepayment subsequent to the Termination Date shall be made by Borrower together with accrued interest on the principal amount so prepaid to the date of such prepayment.

3.7 Distribution of Payments and Prepayments of Notes. All payments of principal and interest and all prepayments of principal on the Notes shall be made by Borrower to Morgan at its office at 23 Wall Street, New York, New York 10015, or such other office as Morgan may designate by notice to Borrower and Banks, before 11:00 a.m. (New York time) on the date due in Immediately Available Funds and shall be distributed on the same day by Morgan to the Banks in Immediately Available Funds: (a) in the case of payments and prepayments of principal, in proportion to the Pro Rata Parts of the respective Banks, and (b) in the case of payments of interest, in proportion to the amounts of interest due and payable to the respective Banks. All payments during the continuation of a Default hereunder shall be credited as follows: (i) first, against expenses due and owing on the Obligation and other amounts (other than principal and interest) due and owing on the Obligation; (ii) second, against the amount of interest accrued and unpaid on the Obligation; (iii) third, against all principal due and owing on the Obligation; and (iv) fourth, as a prepayment of the remaining principal on the Obligation. If any payment or prepayment of principal of or payment of interest on a Note is due on a day other than a Business Day, such payment or prepayment shall be made on the next preceding Business Day.

SECTION 4. Certain Fees.

4.1 Commitment Fee. From and including the date hereof to and including the Termination Date, Borrower shall pay a commitment fee equal to one half of one percent (1/2%) per annum on the average daily unused portion of the Total Committed Sum from time to time; provided, however, that from and including the date hereof until the First Closing Date, such fee shall be calculated separately as to each Bank and the average daily unused portion of each Bank's Pro Rata Part of the Total Committed Sum shall for purposes of calculating the commitment fee be reduced by the average daily principal amount outstanding on such Bank's portion, if any, of the Other Bank Obligation. The commitment fee shall be payable as it accrues on the last Business Day of May 1980, the last Business Day of each August, November, February, and May thereafter, to and including February 28, 1983, and on the Termination Date; shall be payable by Borrower to Morgan in Immediately Available Funds before 11:00 a.m. (New York time) on the date due; and shall be distributed on the same day to each Bank by Morgan in Immediately Available Funds in proportion to such Bank's Pro Rata Part (subject to the foregoing proviso).

4.2 Additional Fees. Borrower shall pay a fee equal to (i) from and including the date hereof to and including the Termination Date, 5% per annum on the product of the Applicable Rate times the average daily Total Committed Sum, and (ii) after the Termination Date, 5% per annum on the product of the Applicable Rate times the average daily Total Principal Debt. Such fee shall be payable as it accrues on the last Business Day of May 1980, the last Business Day of each August, November, February, and May thereafter, to and including the last Business Day of August 1990, and on November 30, 1990; shall be payable by Borrower to Morgan in Immediately Available Funds before 11:00 a.m. (New York time) on the date due; and shall be distributed on the same day to each Bank by Morgan in Immediately Available Funds in proportion to such Bank's Pro Rata Part.

4.3 Further Fees For Certain Banks. On the date of execution and delivery of this Agreement, Borrower shall pay to Morgan for the account of each Bank named below a further fee (representing commitment and additional fees accrued prior to April 28, 1980) in the amount set forth below opposite the name of such Bank. Such fee shall be payable by Borrower to Morgan in Immediately Available Funds, and shall be distributed on the same day to the respective Banks entitled thereto by Morgan in Immediately Available Funds.

Bank	Fee
First National Bank in Dallas	$ 7,713.24
Morgan Guaranty Trust Company of New York	77,132.45
Citibank, N.A.	111,532.01
The Chase Manhattan Bank (National Association)	115,698.68
Bank of America National Trust and Savings Association	77,132.45
Manufacturers Hanover Trust Company	77,132.45
Continental Illinois National Bank and Trust Company of Chicago	53,992.72
The First National Bank of Chicago	53,992.72
Chemical Bank	38,566.24
	$612,892.96

SECTION 5. Conditions Precedent.

(a) Initial Loans. Banks shall not be obligated to make the initial Loans unless:

(i) On the date of execution of this agreement, the Closing Agreement has been executed and delivered;

(ii) On or prior to the First Closing Date the conditions precedent stated in Section 4 of the Closing Agreement have been satisfied by Borrower or waived by all Banks;

(iii) On the First Closing Date, the Other Bank Obligation is paid in full from the proceeds of the initial Loans;

(iv) On or prior to the date of execution of this agreement, the Partnership Agreement has been executed and delivered by the respective parties thereto; and, on or prior to the First Closing Date, (A) the Hunts have contributed to the Partnership all their right, title and interest in and to the Contributed Assets (as defined in the Partnership Agreement), and (B) Banks have received such assurances as Agents or Majority Banks may require that the transactions in connection with the formation of the Partnership contemplated by the Partnership Agreement (including without limitation the transaction involving International Metals Investment Company and Merrill Lynch, Pierce, Fenner & Smith, Incorporated described in Section 9.6 of the Partnership Agreement) can be consummated promptly on a basis satisfactory to Banks;

(v) On or prior to the date of execution of this agreement, the Hunt Guaranty has been executed and delivered by the respective parties thereto and all documents required to be delivered pursuant thereto on or prior to the First Closing Date shall have been delivered and shall be in form and substance satisfactory to Banks;

(vi) On or prior to the First Closing Date, Agents shall have received such evidence as Agents or Majority Banks may require that the settlement of the claims of Engelhard Mineral & Chemicals Corporation ("Engelhard") against the Hunts has been consummated on substantially the terms of the Confirmation dated March 31, 1980, between Engelhard and the Hunts on a basis satisfactory to Banks;

(vii) On or prior to the First Closing Date, Agents have received such evidence as Agents or Majority Banks may require as to state of title to, and perfection of Liens on, such of the Mortgaged Properties and of the properties and assets included in the Hunt Collateral as Agents or Majority Banks may designate; and

(viii) On or prior to the First Closing Date, the Hunt-Placid Loan Agreement has been amended and restated and is in form and substance satisfactory to Agents.

(b) All Loans. In addition to the conditions precedent stated elsewhere herein, Banks shall not be obligated to make any Loans (including the initial Loans) unless:

(i) On the Closing Date for each Loan, and after giving effect thereto, no Default or Potential Default exists which has not been cured by Borrower or waived by Majority Banks;

(ii) The Total Principal Debt, after giving effect to the Loan in question, will be equal to or less than the Total Committed Sum;

(iii) On or before the Closing Date for each Loan, Borrower has delivered to Agents such documents, certificates, and opinions as either Agent may request affirming or reaffirming the satisfaction of any or all conditions and covenants contained in the Loan Papers;

(iv) On the Closing Date for each Loan, Borrower has delivered to Agents a Closing Certificate, and all representations and warranties made therein are true and correct on and as of such Closing Date;

(v) On the Closing Date for each Loan, all representations and warranties made by the Hunts in or pursuant to the Partnership Agreement and the Hunt Guaranty are true and correct in all material respects, and no Hunt Default or Potential Hunt Default under the Hunt Guaranty has occurred and is continuing; and

(vi) On the Closing Date for each Loan, no event shall have occurred and be continuing which could cause a dissolution of the Partnership.

SECTION 6. Certain Covenants. So long as Banks are committed to make Loans, and thereafter until the Obligation is paid and performed in full, Borrower, and each Subsidiary executing and delivering a Guaranty, jointly and severally covenant and agree that, unless Majority Banks indicate in writing that they do not object to a deviation:

6.1 Reports.

(a) Financial Statements and Reports. Borrower will furnish to Banks:

(i) As soon as available and in any event within 120 days after the last day of each fiscal year of the Companies, Financial Statements showing the consolidated financial condition and results of operations of the Companies (other than the Partnership) and the financial condition and results of operations of PIOL and of the Partnership as of, and for the year ended on, such last day, accompanied by (A) an opinion (without material qualification) of Peat, Marwick, Mitchell & Co., or other independent certified public accountants of nationally recognized standing acceptable to Agents, based on an audit using generally accepted accounting auditing standards, that such Financial Statements were prepared in accordance with GAAP and fairly present the consolidated financial condition and results of operations of the Companies and the financial condition and results of operations of PIOL and of the Partnership, (B) a certificate of such accountants (1) stating that, in making the examination necessary for their opinion, they obtained no knowledge, except as specifically stated, of any condition, event, or act which constitutes a Default or Potential Default, and (2) showing computations during such years with respect to compliance with Sections 6.4, 6.5, and 6.7, and (C) an Officer's Certificate with respect to such Financial Statements, which shall include computations with respect to compliance with Sections 6.4, 6.5, and 6.7;

(ii) As soon as available and in any event within 60 days after the last day of each of the first three quarters of each fiscal year of the Companies, Financial Statements showing the consolidated financial condition and results of operations of the Companies (other than the Partnership) and the financial condition and results of operations of PIGL and of the Partnership as of, and for the period from the beginning of the current fiscal year (and for the period from the beginning of such quarter) to, such last day, accompanied by an Officer's Certificate with respect to such Financial Statements, which shall include computations with respect to Sections 6.6 and 6.7; and

(iii) From time to time such further information and certifications regarding the financial condition or business of any of the Companies and engineering data and other information with respect to Hydrocarbon Properties or the assets of the Partnership as Agents on behalf of any Bank may reasonably request.

(b) Engineering Reports. Borrower will furnish or cause to be furnished to Banks:

(i) Engineering reports written by Approved Engineers, effective as of January 1 of the year in question, projecting annually production of Hydrocarbons from all Engineered Properties (setting forth separately those Engineered Properties which are Mortgaged Hydrocarbon Properties and those which are not), the revenue which Obligors can reasonably expect from the sale of such Hydrocarbons, the production and severance taxes (including without limitation any "windfall profits" or similar tax), royalties, cash production expenses, and investments required to be paid or spent to recover the Hydrocarbons, and the resulting Future Net Revenue from Engineered Properties (setting forth separately the Future Net Revenue from Engineered Properties for Mortgaged Hydrocarbon Properties and for Engineered Properties which are not Mortgaged Hydrocarbon Properties). The reports must be written using generally accepted industry practices and must cover the Mortgaged Hydrocarbon Properties, any other Hydrocarbon Properties of Obligors which Majority Banks may designate, and any other Hydrocarbon Properties which Borrower may select. All Banks shall have an opportunity to make their recommendations to Borrower through Agents concerning the various assumptions to be made by the Approved Engineers in writing such reports and the form and content of such reports, and all assumptions and the form and content of such reports must be approved by Banks whose Pro Rata Parts total at least 51%. Engineering reports, prepared as of January 1, 1980, for the Mortgaged Hydrocarbon Properties shall be delivered to Banks not later than June 15, 1980. Future reports shall be submitted as soon as available but not later than April 1 of each year, commencing April 1, 1981. Such reports can be supplemented at any time, such supplements to be delivered to Banks within 90 days following the date of such supplement.

(ii) A Future Net Revenue Computation and Variance Analysis (herein so called), signed by the Vice President of Operations of Borrower, in the form of Exhibit M. Such Analysis must be compiled effective as of January 1 of each year, commencing January 1, 1981, and submitted as soon as available but not later than April 30 of each year, commencing April 30, 1981.

(c) Cash Flow Analysis. Borrower will furnish to Banks:

(i) A Cash Flow Analysis - Total Required Debt Service Test and a Cash Flow Analysis - Annual Required Debt Test (collectively, the "Cash Flow Analysis") signed by the chief financial officer of Borrower, in the forms of Exhibits Q and R, respectively, effective January 1 of each year, to be submitted, with respect to January 1, 1980, on or before the First Closing Date, and thereafter as soon as available but not later than April 30 of each year, commencing April 30, 1981.

(ii) Unless Borrower could incur an additional dollar of Debt under Section 6.4(f) at any time during the then current year, the Cash Flow Analysis - Annual Required Debt Service Test (and, unless the test specified in Section 6.5(a)(i) has theretofore been and continues to be met, the Cash Flow Analysis - Total Required Debt Service Test) must be updated quarterly as of the next following April 1, July 1, and October 1, signed by the chief financial officer of Borrower, and submitted not later than the June 1, September 1, and December 1, respectively, next following.

(iii) Each Cash Flow Analysis shall be prepared on the basis of assumptions (A) as to revenues from, and costs and expenses with respect to, crude oil and gas sales, consistent with the assumptions contained in the most recent engineering report delivered to Banks pursuant to Section 6.1(b), and (B) in the case of revenues from, and costs, expenses, and other financial information with respect to, refinery operations, consistent with historical levels reflected in the audited financial statements delivered to Banks pursuant to Section 6.1(a) (except to the extent that current and anticipated market or other conditions indicate that lower levels of revenues or higher levels of costs and expenses should be assumed). All Banks shall have an opportunity to make their recommendations to Borrower through Agents concerning the various assumptions to be made in preparing each Cash Flow Analysis, and all assumptions must be approved by Banks whose Pro Rata Parts total at least 51%.

(d) Partnership Return Analysis. Borrower will furnish to each Bank requesting the same, on or before the last Business Day of each month, a Partnership Return Analysis in form and detail satisfactory to Agents, showing:

(i) the amount of accrued but unpaid preference returns of the General Partner and the Hunts under the Partnership Agreement at the beginning of the preceding month, the amounts of such preference returns which accrued during such preceding month, the Partnership distributions applied toward satisfaction of such preference returns during such preceding month, and the amount of accrued but unpaid preference returns at the end of such preceding month;

(ii) the amount of unrecovered equity investments of the General Partner and the Hunts at the beginning of such preceding month, the Partnership distributions applied toward discharge of such unrecovered investments during such preceding month, and the amount of such unrecovered investments at the end of such preceding month;

(iii) the accrued but unpaid interest on and unpaid principal balance of the Hunt Note at the beginning of such preceding month, the Partnership distributions applied toward satisfaction and discharge of such unpaid interest and unpaid principal balance during such preceding month, and the accrued but unpaid interest on and unpaid principal of the Hunt Note at the end of such preceding month; and

(iv) sales of assets of the Partnership during such preceding month.

6.2 Merger and Sale of All Assets. No Company will:

(a) Liquidate or dissolve, except that any Company (other than Borrower, the General Partner, the Partnership, and PIOL) may be liquidated or dissolved if all of its assets are distributed to an Obligor; or

(b) Merge or consolidate with or into any other Person, or sell, lease, assign, transfer, or otherwise dispose of all or substantially all of its assets, whether now owned or hereafter acquired unless, after giving effect thereto, no Default or Potential Default will exist and an Obligor is the surviving corporation or is the lessee, assignee, or transferee; provided that Borrower, the General Partner, the Partnership and PIOL may not merge or consolidate with or into any other Person, or sell, lease, assign, transfer, or otherwise dispose of all or substantially all of the assets of any of them, without the consent of Majority

Banks.

6.3 Partial Asset Sales. (a) No Company will sell, lease, transfer, or otherwise dispose of any Mortgaged Properties, other than (i) sales of surplus equipment in the ordinary course of business, (ii) sales of Hydrocarbons after severance in the ordinary course of business, (iii) sales of refined products from the Placid Refineries in the ordinary course of business, (iv) sales and farmouts upon normal and reasonable terms in the ordinary course of business of undeveloped acreage covered by leases held by production, and (v) execution and performance of contracts for the sale of Hydrocarbons so long as (A) the price payable thereunder is market price (or highest lawful price, if lower) at the time of execution, with price escalation provisions which are reasonable and adequate at such time and (B) the obligations of the Companies with respect thereto do not constitute Debt. In the event that any Mortgaged Properties are sold, leased, transferred, or otherwise disposed of with the consent of Majority Banks, the net cash proceeds (other than proceeds of sales permitted by the foregoing provisions of Section 6.3(a)) of such disposition (after allowance for any income or other taxes payable by any Company in connection with such disposition) shall be applied, in the case of Mortgaged Properties securing only the Obligation, as a prepayment on the Obligation, and in the case of Mortgaged Properties securing the Obligation and the 1979 Obligation, as a prepayment of the Obligation and the 1979 Obligation ratably in accordance with the respective amounts of the Total Principal Debt and the 1979 Principal Debt, unless all Banks (and, if such prepayment would otherwise be applied ratably to the 1979 Obligation, all banks parties to the 1979 Loan Agreement) otherwise consent in writing.

(b) No Company will permit the Partnership to sell, lease, transfer, or otherwise dispose of any asset unless the proceeds of such dispositions of assets are distributed as provided in the Partnership Agreement and remitted to Morgan as a mandatory prepayment as required by Section 6.8(d).

6.4 Permitted Debt. No Company will create, incur, assume or suffer to exist any Debt other than Permitted Debt (herein so called), which means:

(a) The Obligation, which, for the purposes of this section, until the Termination Date, means the Total

Committed Sum, and thereafter means the Total Principal Debt, plus accrued interest and fees;

(b) Existing Debt (herein so called), which term means the unpaid balance on the Determination Date of the following Debts:

(i) Guaranties and other obligations with respect to the Noordgastransport Debt (herein so called) (Indebtedness under Multicurrency Credit Agreement dated December 18, 1973, among Noordgastransport and a group of banks, providing credit facilities in the amount of 65,000,000 Dutch Guilders and $75,000,000, as amended December 1, 1976, to increase the dollar facility by $54,000,000, and as amended as of June 30, 1979. The outstanding principal balance of the Noordgastransport Debt at March 31, 1980, was $83,415,000 and 37,770,000 Dutch Guilders);

(ii) Indebtedness of Borrower for advances from two transmission companies, aggregating $18,758,702 at March 31, 1980;

(iii) Indebtedness of Borrower to Promenade National Bank in the amount of $300,000;

(iv) 6% promissory note of PIOL to Ex-Im Bank with a principal balance of $1,879,346 at March 31, 1980, payable in five semi-annual installments beginning in 1979;

(v) 6% promissory note of PIOL to Ex-Im Bank with a principal balance of $2,880,000 at March 31, 1980, payable in five semi-annual installments beginning in 1980;

(vi) Throughput obligations of Borrower in connection with Paloma Pipeline (in the amount of $314,000), Parish Pipeline (in the amount of $150,000), and Black Lake Pipeline (in the amount $2,645,000), as of March 31, 1980;

(vii) The 1979 Obligation;

(viii) Margin Debt in the aggregate amount of $162,000,000 at April 30, 1980;

(ix) Partnership Debt outstanding at the First Closing Date, in an amount not to exceed $1,150,000,000; and

(x) Until the First Closing Date, the Other Bank Obligation.

provided, that the unpaid balance of each Existing Debt described in this Section 6.4(b) shall never (for the purposes of this section) be greater than the unpaid balance for each such Existing Debt as of any prior Determination Date.

(c) Intercompany Debt (herein so called), which term means any Debt which is owed by any Company to any other Company if it arose pursuant to a loan or advance permitted by Section 6.7.

(d) Additional Pipeline Debt (herein so called) in a principal amount not exceeding $30,000,000, representing purchase money Debt in connection with the proposed acquisition of a certain established intra-state gas-gathering system in an area in Louisiana where Borrower has substantial operations (the "Additional Pipeline").

(e) After the Cash Flow Maintenance Tests are first met, Permitted Nonrecourse Secured Debt (herein so called), which term means Debt of a Company other than the Partnership secured by Liens on assets of such Company (including, without limitation, Hydrocarbon Properties, but excluding Mortgaged Properties), if (i) the lender must look solely to the encumbered assets for satisfaction of the Debt and has no recourse to any Obligor or any other assets of any of the Companies, and (ii) the aggregate of all Permitted Nonrecourse Secured Debt does not exceed 15% of the total Permitted Debt under Sections 6.4(a), (b)(i)-(viii), and (f).

(f) After the Cash Flow Maintenance Tests are first met, Additional Debt (herein so called) of Borrower (but not any other Company) which term means unsecured Debt, if, after giving effect to the incurrence of any such Additional Debt, on a pro forma basis, the Cash Flow Maintenance Tests continue to be met.

For the purposes of this Section 6.4(f) and Section 6.5 short term Debt payable on demand or having a maturity of one year or less, up to $100,000,000, shall be deemed, as of any Determination Date, to be amortizable in equal annual installments of principal and interest over the then remaining term of the Notes issued under the 1979 Loan Agreement; provided, that short term Debt in excess of such $100,000,000 and not specifically provided for elsewhere herein shall, for the purpose of calculating interest thereon, be deemed to be outstanding for the remaining term of the Notes issued under the 1979 Loan Agreement.

For purposes of this Section 6.4(f) and Section 6.5, the terms Total Required Debt Service and Annual Required Debt Service shall include interest (I) and/or principal (P) payments on Permitted Debt as indicated below:

Permitted Debt	Total Required Debt Service	Annual Required Debt Service
6.4(a) (The Loans)	P+I	P+I
6.4(b) (Existing Debt other than Noordgastransport Debt, Margin Debt and Partnership Debt)	P+I	P+I
6.4(b) (Noordgastransport Debt)	none	none
6.4(b) (Margin Debt)	(x)	(x)
6.4(b) (Partnership Debt)	none	none
6.4(c) (Intercompany Debt)	none	none
6.4(d) (Additional Pipeline Debt)	P+I	P+I
6.4(e) (Permitted Non-recourse Secured Debt)	none	P+I
6.4(f) (Additional Debt)	P+I	P+I(y)
6.4(g) (Lease obligations)	none	none
6.4(h) (Purchase money note)	none	none
6.4(i) (Short-term Debt)	P+I(z)	P+I(z)
6.4(j) (Additional Partnership Debt)	none	none

(x) None for purposes of any Determination Date prior to May 31, 1981; thereafter, P+I.

(y) See the second paragraph of this Section 6.4(f) for the manner in which principal payments are to be amortized on a pro forma basis with respect to short term Debt.

(z) Principal assumed to be paid at maturity.

(g) Lease obligations of any Company (other than the Partnership), to the extent not prohibited by Section 6.9.

(h) Purchase-money note in the amount of approximately $5,000,000 as a part of the approximately $16,000,000 purchase price for certain California real estate which Borrower has contracted to purchase, which real estate will subsequently be conveyed to N.B. and W.H. Hunt in exchange for the land on Elm Street, Dallas, Texas, on which Borrower is building an office building, at the time of which conveyance, N.B. and W.H. Hunt will assume and be liable for the payment of such note.

(i) Short-term Debt in an amount not to exceed $21,000,000 incurred in connection with the consummation of the acquisition of substantially all the assets of Hunt International Petroleum Company (United Kingdom) as described in Section 6.7(b)(v).

(j) Additional Partnership Debt (herein so called), which term means Debt of the Partnership (i) with respect to which none of the Companies other than the Partnership and the General Partner has any liability or obligation whatsoever, (ii) which is incurred solely for the purpose of financing margin requirements in connection with Qualified Future Sale Transactions and (iii) which may at any time be secured by the pledge of (A) silver or warehouse receipts evidencing the ownership of silver in a quantity not in excess of the aggregate number of troy ounces of silver then covered by Qualified Future Sale Transactions of the Partnership and (B) the interest of the Partnership in the futures contracts which are the subject of such Qualified Future Sale Transactions.

6.5 Cash Flow Coverage. (a) Subject to Section 6.5(b), Borrower will not permit, as of any Determination Date or as of any prospective anniversary of such Determination Date during the remaining term of the Loans, on a pro forma basis, (i) Cash Flow from Engineered Properties for the life of such properties to be less than 166% of pro forma Total Required Debt Service, or (ii) Consolidated Cash Flow from All Operations in the next succeeding 12 months to be less than 125% of pro forma Annual Required Debt Service.

(b) The requirements of Section 6.5(a) (herein referred to as the "Cash Flow Maintenance Tests") shall not become effective until the earlier of: (i) the Termination Date or (ii) the date subsequent to the date hereof when the Cash Flow Maintenance Tests are first met.

(c) Borrower will not permit, as of any Determination Date prior to the date upon which the Cash Flow Maintenance Tests become effective or as of any prospective anniversary of such Determination Date during the remaining term of the Loans, on a pro forma basis, Consolidated Cash Flow from All Operations in the next succeeding 12 months, on a pro forma basis, to be less than 105% of pro forma Annual Required Debt Service.

6.6 Permitted Liens. No Company will create, incur, assume, or suffer to exist any Liens other than Permitted Liens (herein so called), which means:

> (a) Pledges or deposits made to secure payment of workmen's compensation, or to participate in any fund in connection with workmen's compensation, unemployment insurance, pensions, or other social security programs;
>
> (b) Good faith pledges or deposits made to secure performance of bids, tenders, contracts (other than contracts creating or evidencing Debt), or leases, not in excess of 10% of the aggregate amount due thereunder, or to secure statutory obligations, surety or appeal bonds, or indemnity, performance, or other similar bonds in the ordinary course of business;
>
> (c) Encumbrances consisting of zoning restrictions, easements, or other restrictions on the use of real property, none of which materially impair the use of such property by the Person in question in the operation of its business, and none of which is violated by existing or proposed structures or land use;
>
> (d) The following, if the validity or amount thereof is being contested in good faith and by

appropriate and lawful proceedings and so long as (i) levy and execution thereon have been stayed and continue to be stayed, (ii) they do not in the aggregate materially detract from the value of the property of the Person in question, or materially impair the use thereof in the operation of its business, and (iii) a reserve, if appropriate, has been established: Claims and Liens for Taxes due and payable; claims and Liens upon, and defects of title to, real or personal property, including any attachment of personal or real property or other legal process prior to adjudication of a dispute on the merits; claims and Liens of mechanics, materialmen, warehousemen, or carriers, or other like Liens; and adverse judgments on appeal;

(e) Liens for Taxes not yet due and payable;

(f) Mechanics' and materialmen's Liens for services or materials for which payment is not yet due;

(g) Liens securing the Obligation and Liens granted in accordance with this agreement to secure the 1979 Obligation;

(h) Liens on Margin Stock to secure Margin Debt existing on the date hereof;

(i) Lien on gas production from "South Marsh Island Block 269 Field" securing a portion of the advances referred to in Section 6.4(b)(ii);

(j) Liens which now secure the Noordgastransport Debt;

(k) Operators' Liens incurred pursuant to operating agreements entered into by a Company in the ordinary course of business which Liens do not secure Debt;

(l) Liens on the Additional Pipeline to secure the Additional Pipeline Debt;

(m) Liens securing Permitted Nonrecourse Secured Debt if the criteria stated in Section 6.4(e) are satisfied;

(n) Liens existing on the date hereof on assets of the Partnership securing Partnership Debt;

(o) Liens on the real estate referred to in Section 6.4(h) securing the note referred to therein; and

(p) Liens on Partnership assets securing Additional Partnership Debt if the criteria stated in Section 6.4(j) are met, and Liens on Partnership assets covering silver or warehouse receipts evidencing the ownership of silver securing the obligation of the Partnership under a contract relating to a Qualified Forward Sale Transaction in a quantity not in excess of the aggregate number of troy ounces of silver covered by such contract.

6.7 Distributions and Investments. (a) No Company will make any Distribution (other than distributions by the Partnership required under the Partnership Agreement) (i) until the Cash Flow Maintenance Tests are met and (ii) thereafter, unless (A) no Default or Potential Default has occurred and is continuing, or will occur after giving effect to such Distribution, and (B) the cumulative amount of Distributions in any calendar year, after giving effect to such Distribution, shall not exceed an amount (noncumulative) equal to 15% of the consolidated net income after taxes of the Companies (excluding the Partnership), determined in accordance with GAAP, for the preceding year; provided that Borrower may make the loans contemplated by Section 6.7(b)(vii) and may consummate the acquisition contemplated by Section 6.7(b)(v).

(b) No Company will make any Investment other than (i) contributions by General Partner to the capital of the Partnership not exceeding in the aggregate $975,000,000 plus additional contributions not exceeding $1,000,000 in any 12-month period for operating expenses of the Partnership and taxes, royalties, and other expenses resulting from ownership of the coal properties comprising a part of the Partnership assets, (ii) Investments by an Obligor in an Obligor, (iii) acquisition of the Additional Pipeline for a purchase price not exceeding $40,000,000, (iv) Investments in short term United States government obligations, certificates of deposits of and time deposits in commercial banks with capital, surplus, and undivided profits exceeding $300,000,000, and short term commercial paper rated in the highest category by a nationally recognized rating agency, (v) consummation by Borrower of the acquisition of substantially all the assets of Hunt International Petroleum Corporation (United Kingdom) on substantially the terms described in a May 15, 1980 telex from Agents to banks participating in the 1979 Loan Agreement, (vi) ordinary and necessary expenditures in connection with refining operations, lease acquisitions and exploration and development activities, (vii) loans of up to an additional $25,000,000 by Borrower to the Hunts as contemplated by the Partnership Agreement, (viii) the acquisition and exchange referred to in Section 6.4(h), and (ix) other Investments (other than Investments in Insiders and Investments by the Partnership) not exceeding $1,000,000 per year (noncumulative).

6.8 Partnership Agreement; Hunt Notes.

(a) Upon request by Majority Banks, Borrower will cause General Partner to (i) demand and (ii) diligently pursue payment of the Hunt Commitment.

(b) Borrower will not permit General Partner to grant any waivers or consents under, or enter into any amendment or modification of, the Partnership Agreement without the prior written consent of Majority Banks.

(c) Borrower will cause General Partner to perform its obligations, and to enforce the obligations of the Hunts, under the Partnership Agreement.

(d) Borrower will remit to Morgan as a mandatory prepayment on the Obligation, (i) immediately upon receipt thereof by General Partner, an amount equal to the amount of any distribution received (not including a distribution deemed made in accordance with Section 6.7 of the Partnership Agreement) by General Partner pursuant to the Partnership Agreement, and (ii) immediately upon receipt thereof by Borrower, an amount equal to the amount of any payment received by Borrower on the Hunt Notes, in either case including any such distribution or payment by reason of sales of collateral pursuant to Section 6.8(g).

(e) Borrower will not permit General Partner to engage in any business or to make any Investment except as contemplated by the Partnership Agreement.

(f) Borrower will not permit General Partner to resign as general partner of the Partnership or to perform or omit to perform any act which performance or omission would result in the dissolution of the Partnership.

(g) Borrower will not, and will not permit General Partner or the Partnership to, release any collateral securing the Hunt Commitment or the Hunt Notes without the prior written consent of Majority Banks; provided, however, that Banks shall give such consent to Borrower, General Partner and the Partnership under the circumstances and subject to the conditions under which they agree to release their lien upon such collateral pursuant to Sections 7.2, 7.3 and 11.9(c) of the Hunt Guaranty.

6.9 Lease Obligations. The Companies will not incur or allow the total rental obligations under leases and subleases of real and/or personal property (other than Hydrocarbon leases, drilling rig leases or contracts, and leases of office space and office equipment for use by the Companies in their operations, and other than leases under which both the lessor and the lessee are Obligors) to exceed at any time an amount equal to 2.5% of the maximum amount of Permitted Debt under Sections 6.4(a), (b)(i)-(viii), and (f).

6.10 Books and Records. The Companies will keep, in accordance with GAAP, proper and complete books, records, and accounts and permit any Bank to inspect the same and make and take away copies thereof.

6.11 Notice of Litigation or Changes in Fact. The Companies will promptly notify Agents of (i) the existence and status of any Litigation which individually or in the aggregate could, in the event of an unfavorable outcome, have a Material Adverse Effect, (ii) any change in any material fact or circumstance represented or warranted in any of the Loan Papers, and (iii) a Default or Potential Default, specifying the nature thereof and what action the Companies have taken, are taking, and/or propose to take with respect thereto.

6.12 Taxes. The Companies will promptly pay when due any and all Taxes payable by any Company, except Taxes being contested in good faith by appropriate legal proceedings with respect to which the criteria stated in Section 6.6(d) have been satisfied.

6.13 Expenses of Banks. Borrower will promptly pay and hereby indemnifies Banks, and each of them, against and agrees to hold Banks, and each of them, harmless from, the following (all of which shall be and become a part of the Obligation): (i) all reasonable costs, fees, and expenses paid or incurred by Agents incident to any of the Loan Papers (including, but not limited to, the reasonable fees and expenses of counsel to Agents and any special counsel retained by Banks in connection with the negotiation, preparation, and execution hereof and any amendment hereto, whether or not any Loan is ever made, and in connection with the making of any Loan) or to the enforcement of the obligations of any of the Companies, (ii) all reasonable costs, fees, and expenses paid or incurred by any Bank in the exercise of any Rights after Default (including, but not limited to, reasonable attorneys' fees and court costs), and (iii) any and all losses, claims, damages, liabilities, and expenses (including but not limited to, reasonable attorneys' fees and court costs) paid or incurred by any Bank which arise out of or in connection with the use or uses of the proceeds of any Loans.

6.14 Maintenance of Corporate Existence, Assets, Business, and Insurance. Except as otherwise permitted by Section 8.2, each Company will at all times (i) maintain its legal existence and authority to transact business and good standing in its jurisdiction of organization and all other jurisdictions where the failure to so maintain might have a Material Adverse Effect; (ii) maintain all licenses, permits, and franchises necessary for its businesses; (iii) keep all of its tangible assets which are useful and necessary in its businesses in good working order and condition; (iv) make all necessary repairs to and replacements of such assets; (v) maintain, or cause to be maintained, insurance with such insurers, in such amounts, and covering such risks as shall be substantially in accordance with industry practice; and (vi) from time to time, upon request by Agents, deliver to Banks schedules showing all insurance of the Companies then in effect.

6.15 Additional Guaranties. The Companies shall cause each existing and future Subsidiary (other than the Partnership, which shall not be a Guarantor) specified by Agents or Majority Banks to duly execute and deliver to Banks a Guaranty, unconditionally guaranteeing full payment and complete performance of the Obligation, and shall promptly notify Agents of the formation and/or acquisition of any

Subsidiary after the date hereof.

6.16 Information and Other Documents. The Companies shall promptly deliver to Banks such information (not otherwise required to be furnished under the Loan Papers) respecting the business, affairs, assets, and liabilities of any of the Companies and of the Hunts (to the extent made available by the Hunts to any Company), and such opinions, certifications, and documents, in addition to those mentioned in this agreement, as Agents on behalf of any Bank may reasonably request, and allow each Bank to inspect any of the properties of any Company and to discuss any of the affairs, conditions, and finances of the Companies with any director, officer, or employee thereof, from time to time, during reasonable business hours.

6.17 Use of Proceeds. The proceeds of Loans will be used by Borrower solely for paying the Other Bank Obligation, for paying costs, fees, and expenses pursuant to Section 6.13, for normal operating needs, and for the making of the Investments permitted by Section 6.7. Borrower will not use the proceeds of any Loans in violation of any condition, covenant, representation, or warranty herein or in any Closing Certificate.

6.18 Compliance with Laws and Documents. None of the Companies will, directly or indirectly, violate the provisions of any Laws, the certificate of incorporation or bylaws of any of the Companies, or any Material Agreement of any of the Companies, if such violation, alone or when combined with all other such violations, could have a Material Adverse Effect. Each Company will maintain its ability to perform its obligations under each Material Agreement to which it is a party.

6.19 Primary Business. The exploration for, and production, refining, transportation, and marketing of, Hydrocarbons will continue to be the primary business of the Companies (other than the Partnership) taken as a whole.

6.20 Exceptions to Covenants. The Companies shall not be deemed to be permitted to take any action or fail to take any action which is permitted by any of the covenants contained in this agreement if such action or omission would result in the breach of any other covenant contained in this agreement.

6.21 Issuance of Equity Securities. Borrower will not issue any additional Equity Securities to any Person other than its present shareholders, and none of the other Companies will issue any additional Equity Securities to any Person other than an Obligor.

6.22 Ratable Prepayments. Borrower will not, and will not permit PIOL to, make any optional prepayment of the 1979 Principal Debt unless simultaneously therewith Borrower prepays pursuant to Section 3.6(a) hereof an amount which bears the same proportion to the Total Principal Debt as the amount to be prepaid on the 1979 Principal Debt upon such date bears to the total outstanding 1979 Principal Debt on such date.

6.23 Sales to Affiliates. No Company will sell, lease, transfer, or otherwise dispose of any asset to any Affiliate (other than an Obligor), except pursuant to a Distribution or Investment permitted by Section 6.7.

6.24 No Speculation. No Company will (a) take any new commodities position which results in a net increase in such positions or (b) take any new commodities position for any speculative purpose. It is understood and agreed that the rolling forward of existing gold and silver futures positions of Borrower for hedging purposes in connection with awards heretofore made under an employee benefit plan of Borrower would not involve a net increase in Borrower's position or be for a speculative purpose. It is further understood and agreed that the entering into by the Partnership of Qualified Forward and Future Sale Transactions would not involve a net increase in the Partnership's silver position or be for a speculative purpose so long as the aggregate number of troy ounces of silver at any time covered by all Qualified Forward and Future Sale Transactions to which the Partnership is a party does not exceed the aggregate number of troy ounces of silver then owned by the Partnership. It is further understood and agreed that the rolling forward of existing forward purchase contracts would not involve a net increase in the Partnership's silver position or be for a speculative purpose.

SECTION 7. Collateral; Placid Agent Account.

7.1 Collateral. (a) Immediately after execution hereof, the Companies will commence, and thereafter proceed diligently to grant to Agents at the earliest possible time (but in any event within the respective time periods specified below) prior Liens (subject only to Permitted Liens) on the following:

(i) To secure the Obligation and the 1979 Obligation:

(A) All of the interests of the Companies in the Hydrocarbon Properties described in Schedule Three ("Mortgaged Hydrocarbon Properties"), all rights of the Companies in and under all contracts and agreements relating to the Mortgaged Hydrocarbon Properties, and all interests of the Companies in Hydrocarbon Related Assets used in connection with Mortgaged Hydrocarbon Properties, such Liens to be granted and perfected:

(w) within six (6) months after the execution and delivery hereof, with respect to the "L-10/11 Field" described on Schedule Three;

(x) contemporaneously with the execution and delivery hereof, with respect to the Mortgaged Hydrocarbon Properties referred to under items 9-19, inclusive, 24-31, inclusive, and 72-107, inclusive, on Schedule Three;

(y) within 30 days after the execution and delivery hereof, with respect to the Mortgaged Hydrocarbon Properties referred to under items 20-23, inclusive, and 109-114, inclusive, on Schedule Three; and

(z) within 10 days after the execution and delivery hereof, with respect to all other Mortgaged Hydrocarbon Properties;

(B) The refineries in Louisiana and Texas owned by Placid Refining Company, a Delaware corporation and a wholly owned Subsidiary of Borrower and all pipeline systems servicing such refineries, such Liens to be granted and perfected:

(x) contemporaneously with the execution and delivery hereof, with respect to the Louisiana refinery; and

(y) within 10 days after the execution and delivery hereof, with respect to the Texas refinery.

(C) All issued and outstanding capital stock of all Subsidiaries (other than the Partnership and General Partner), and the stock of Paloma Gas Pipe Line Company owned by Borrower, such Liens to be granted and perfected on or prior to the First Closing Date;

(D) The indebtedness of DSM Aardgas B.V. to PIOL under an Agreement of Co-Operation dated October 15, 1976 as to which the amount outstanding as of May 2, 1980 was 84,595,156 Dutch Guilders (the "DSM Debt"), such Lien to be granted and perfected within six (6) months after the execution and delivery hereof; and

(E) The Additional Pipeline, such Lien to be granted and perfected within 30 days after a Company acquires the Additional Pipeline;

(ii) To secure the Obligation:

(A) The partnership interest of General Partner in the Partnership, such Lien to be granted and perfected on or prior to the First Closing Date;

(B) All issued and outstanding capital stock of General Partner and the Hunt Notes, such Lien to be granted and perfected on or prior to the First Closing Date; and

(C) The coal properties to be contributed to the Partnership by the Hunts, such Lien to be granted and perfected within 30 days after the contribution of such properties to the Partnership.

(b) The Companies will, promptly upon request by Majority Banks, grant to Agents for the benefit of Banks and, if Agents so indicate, the holders of the 1979 Obligation, prior Liens (subject only to Permitted Liens) on such other properties, assets or rights, tangible or intangible, of the Companies as Agents or Majority Banks may designate.

(c) The Companies shall promptly execute and deliver such agreements, mortgages, deeds of trust, security agreements, assignments, and other documents and agreements as Agents may reasonably request in order to create, perfect, and maintain such Liens, including transfer orders addressed to the purchasers of production from the Mortgaged Hydrocarbon Properties, which transfer orders will be held by First in Dallas until Agents, at their discretion or upon request by Majority Banks, but only after the occurrence of a Default or a Potential Default, deliver such transfer orders to such purchasers. Agents and Banks shall not be entitled to exercise their Rights under the various collateral documents to cause proceeds of production to be paid to them until after the occurrence of a Default or Potential Default.

(d) The Companies shall deliver, on or prior to the First Closing Date in the case of the Mortgaged Properties described in clauses (i)(C), (i)(D), (ii)(A) and (ii)(B) of Section 7.1(a), and promptly after the granting thereof, in the case of other Mortgaged Properties, such certificates, opinions of counsel, and other evidence of the validity, enforceability, priority, and perfection of such Liens, all in form and substance satisfactory to Majority Banks, as Agents may reasonably request on behalf of Majority Banks.

(e) Upon any sale permitted by the first sentence of Section 6.3(a) or upon the execution of any farmout or Hydrocarbon sale contract permitted by such sentence, Agents shall be obligated, upon request by Borrower, to execute an appropriate release or other instrument relating to the property sold or property affected by such farmout or Hydrocarbon sale contract, recognizing the rights of the purchaser or farmee, but preserving the Liens of the Banks insofar as any retained interest of Borrower is concerned.

(f) No Lien created pursuant to this Section 7 shall inure to the benefit of any non-domestic bank (referred to herein as a "Foreign Bank") to the extent that, if such benefits so inured to such Foreign Bank, such Foreign Bank would thereby acquire or hold an interest in Mortgaged

Property in violation of applicable Law, and no such Foreign Bank shall participate in any determination of the Banks to give or withhold consent to the disposition of any Mortgaged Property by the Borrower, or to direct the Agents with respect to foreclosure upon or otherwise exercise Rights with respect to, any such Mortgaged Property, to the extent that, by reason of such participation, such Foreign Bank would thereby acquire or hold such an interest.

(g) Upon foreclosure or other exercise of remedies with respect to the Mortgaged Properties by Agents, the proceeds of any sale of, or other realization upon, all or any part thereof shall be applied by Agents in the following order of priorities:

> first, to payment of the expenses of such sale or other realization, including reasonable compensation to Agents and their agents and counsel, and all expenses, liabilities and advances incurred or made by Agents in connection therewith;
>
> second, (i) in the case of Mortgaged Properties securing the Obligation and the 1979 Obligation, to payment thereof in proportion to the respective amounts of the Total Principal Debt and the 1979 Principal Debt, equally and ratably, for application in accordance with Sections 3.7 and 10.6 hereof and the applicable provisions of the 1979 Loan Agreement, until the Obligation and the 1979 Obligation have been paid in full; and (ii) in the case of Mortgaged Properties securing only the Obligation, in accordance with Sections 3.7 and 10.6 hereof, until the Obligation has been paid in full; and
>
> finally, to payment to the appropriate Company or its successors or assigns, or as a court of competent jurisdiction may direct, of any surplus then remaining from such proceeds.

The Agents may make distributions in cash or in kind or, on a ratable basis, in any combination thereof. Proceeds of any sale of, or other realization upon, all or any part of the Hunt Collateral shall be applied as provided in the Hunt Guaranty.

7.2 Placid Agent Account. All proceeds of each Loan shall be remitted by Morgan to First in Dallas for the account of Borrower in Immediately Available Funds on the date of such Loan. Borrower shall transfer into a special account with First in Dallas (the "Partnership Account") all amounts which Borrower proposes to advance to General Partner or the Hunts. Borrower, Hunts, and First in Dallas have entered into a Supplemental Agreement dated May 22, 1980, and effective as of April 8, 1980, regarding the Partnership Account, a copy of which Supplemental Agreement has been supplied to Banks. Borrower and Hunts have given First in Dallas appropriate indemnifications covering actions taken by First in Dallas in carrying out its responsibilities as set forth in the Supplemental Agreement.

SECTION 8. Default. The term "Default", as used herein, means the occurrence of any one or more of the following events (including the passage of time, if any, specified therefor) (provided that if any such event occurs and Majority Banks subsequently agree in writing that they will not exercise any Rights hereunder as a result thereof, the occurrence of such event shall no longer be deemed a "Default" hereunder insofar as the state of facts giving rise to such event is concerned, but the same shall not operate as or be deemed to be a waiver with respect to any identical or similar state of facts in existence or occurring thereafter):

8.1 Payment of the Loans. The failure or refusal of Borrower to pay principal of (including without limitation any mandatory prepayment) or interest on any Note, or any part thereof, or any fees payable pursuant to Section 4, as the same become due; or

8.2 Covenants. (a) Any Company breaches or violates any of the covenants contained in Section 6.2, 6.3, 6.4, 6.5, 6.6, 6.7, 6.8(a)(i), 6.8(b)-(g), 6.9, 6.17, 6.21, or 7.1; or (b) any Company fails or refuses to punctually and properly perform, observe, and comply with any covenant contained in any of the Loan Papers (other than the covenants covered by Section 8.1 or by the foregoing clause (a) of this Section 8.2), and such failure or refusal continues for a period of 30 days after any Company knows or should have known of such failure or refusal or after any Bank notifies Borrower thereof; or

8.3 Voluntary Debtor Relief. Any Company shall (a) become insolvent, or (b) execute or make an assignment for the benefit of creditors or make a proposal to its creditors under any Debtor Relief Laws, or (c) admit in writing its inability to pay its debts generally as they become due, or (d) voluntarily seek, consent to, or acquiesce in the benefit or benefits of any Debtor Relief Law, or (e) become a party to any proceeding provided for by any Debtor Relief Law that could suspend or otherwise affect any of the Rights of Banks granted in the Loan Papers, or (f) consent to the appointment of a receiver, trustee, liquidator, conservator, or similar Person for it or all or substantially all of its assets; or

8.4 Involuntary Proceedings. Any of the Companies shall involuntarily (a) have an order, judgment, or decree entered against it by any Tribunal pursuant to any Debtor Relief Law that could suspend or otherwise affect any of the Rights granted to Banks in any of the Loan Papers, or (b) have a petition filed against it seeking the benefit or benefits provided for by any Debtor Relief Law that would suspend or otherwise affect any of the Rights granted to Banks in any of the Loan Papers; or

8.5 Attachment. The failure to have discharged or stayed within a period of 30 days after the commencement thereof any attachment, sequestration, or similar proceeding against any material assets of any of the Companies; or

8.6 Payment of Judgments. Any of the Companies fails to pay any money judgment against it at least 10 days prior to the date on which any of the material assets of any of the Companies may be lawfully sold to satisfy such judgment; or

8.7 Impairment of Ability to Pay. The delivery by Majority Banks of notice to Borrower and the other Banks that they believe that the prospect of payment or performance of the Obligation is materially impaired and the situation giving rise thereto is not corrected to the satisfaction of Majority Banks within 20 days after such notice is received by Borrower; or

8.8 Failure to Pay Other Debt. (i) Any Company fails or refuses to pay when due (or renew or extend, with the agreement of the creditor) any Debt owed by it, and such failure or refusal continues beyond the applicable grace periods related thereto; or (ii) any condition or event occurs which, with the passage of time or the giving of notice or both would cause, or would permit the holder thereof to cause, the acceleration of the maturity of any Debt owed by any Company; or

8.9 Misrepresentation. Any statement, representation, or warranty of any Company in the Loan Papers or in any writing ever delivered by any Company to any Bank in compliance with the Loan Papers is false, misleading, or erroneous in any material respect on the date as of and when made; or

8.10 Officers and Directors. Any of William Herbert Hunt, Nelson Bunker Hunt, or Lamar Hunt is elected or appointed a director or officer of any Company;

then, in any such event, if such event shall be continuing, Agents may, at their election, and shall, if requested in writing by Banks whose Pro Rata Parts total at least 34%, terminate the commitments of Banks to lend hereunder and/or declare the aggregate unpaid principal amount of and interest on the Notes to be, and the same shall thereupon forthwith become, due and payable without diligence, presentment, demand, protest, notice of protest, dishonor, or acceleration, or other notice of any kind, all of which are hereby expressly waived. If a Default specified in Section 8.3 or 8.4 above occurs, the aggregate unpaid principal amount of and interest on the Notes shall thereupon become due and payable concurrently therewith, without any action by Agents or Banks and without diligence, presentment, demand, protest, notice of protest, dishonor, or acceleration, or other notice of any kind, all of which are hereby expressly waived. After any acceleration, Agents will use reasonable efforts to notify Borrowers thereof. If a Default under Section 8.4 occurs and, within 60 days thereafter, any order, judgment, or decree under Section 8.4(a) is permanently stayed or enjoined or any petition under Section 8.4(b) is discharged, Banks will rescind any acceleration if all other Defaults and Potential Defaults are cured.

SECTION 9. Certain Definitions.

For purposes of this agreement, the following terms shall have the respective meanings set forth below:

"Additional Debt" has the meaning stated in Section 6.4(f).

"Additional Partnership Debt" has the meaning stated in Section 6.4(j).

"Additional Pipeline" has the meaning stated in Section 6.4(d).

"Additional Pipeline Debt" has the meaning stated in Section 6.4(d).

"Adjusted CD Rate" means the sum of (a) the product of (i) the Average Weekly Three Month Secondary CD Rate times (ii) a fraction of which the numerator is 100% and the denominator is 100% minus the aggregate rates of (A) basic and supplemental reserve requirements in effect on the Determination Date under Regulation D applicable to certificates of deposit in units of $100,000 or more issued by a "member bank" located in a "reserve city" (as such terms are used in Regulation D) and (B) marginal reserve requirements in effect on the Determination Date under Regulation D applicable to time deposits of a "member bank", and (b) 1/2%.

An "Affiliate" of another Person means any Person who (i) controls, is controlled by, or is under common control with such other Person or (ii) is an Insider.

"Agents" means First in Dallas and Morgan.

"Agreement Among Creditors" means the Agreement Among Creditors to be entered into pursuant to Section 4(q) of the Closing Agreement.

"Alternate Base Rate" means the rate per annum, calculated daily, at all times equal to the higher of the Prime Rate or the Adjusted CD Rate.

"Amortization Percentage" has the meaning stated in Section 3.4.

"Annual Required Debt Service" means the sum of projected required principal and interest payments on all Debt of the Companies (other than principal and/or interest payments on Debt excluded as stated in Section 6.4(f)) which are required to be paid during the 12 months in question, or which are payable on demand, based upon the assumption that the interest rate on all Debt (other than Debt with a rate fixed throughout the term of such Debt) will be 20% through

December 31, 1980, and 15% after December 31, 1980, unless it reasonably appears to Agents that actual interest rates will be materially different from those indicated, in which case rates specified by Agents (or, if Majority Banks object to rates so specified, rates specified by Majority Banks) will be utilized.

"Applicable Rate" means (i) to and including April 8, 1983, 103% of the sum of the Alternate Base Rate plus one half of one percent (1/2%), and (ii) after April 8, 1983, 105% of the sum of the Alternate Base Rate plus one half of one percent (1/2%).

"Approved Engineers" means Core Laboratories, Inc., DeGolyer & MacNaughton, or other independent petroleum engineers acceptable to Majority Banks.

"Average Weekly Three Month Secondary CD Rate" means the three month secondary certificate of deposit ("CD") rate for the most recent weekly period covered therein in the Federal Reserve statistical release entitled "Weekly Summary of Banking and Credit Measures (Averages of daily figures)" which was released in the week preceding the week for which the CD rate is being determined. The CD rate so reported shall be in effect, for the purpose of this definition, for each day of the week commencing the Monday following the release date of such publication. If such publication or a substitute containing the foregoing rate information is not published by the Federal Reserve for any week, such average rate shall be determined by Morgan on the basis of quotations received by it from three New York commercial paper dealers of recognized standing.

"Banks" means the banks named on Schedule One.

"Borrower" means Placid Oil Company, a Delaware corporation.

"Business Day" means any day other than a Saturday or Sunday or other day on which commercial banks in New York City are authorized by law to close.

"Cash Flow Maintenance Tests" has the meaning stated in Sections 6.5(a) and (b).

"Cash Flow from Engineered Properties" means Future Net Revenue from Engineered Properties, minus all projected cash income tax payments and general and administrative expenses (based on historical levels), as calculated on Exhibit Q. The total general and administrative expenses of the Companies will be allocated to Engineered Properties in the proportion which the operating profits allocable to the Engineered Properties bears to the total consolidated operating profits of the Companies. For the purpose of calculating income tax payments in respect of Engineered Properties, all noncash deductions of the Companies, as reflected on the tax books of the Companies, will be allocated to the Engineered Properties. Whenever, in connection with a particular computation, less than all of the Engineered Properties are taken into account, income tax payments and general and administrative expenses shall be allocated among all Engineered Properties ratably in proportion to the Future Net Revenues from Engineered Properties of each such property.

"Closing Agreement" means that certain Closing Agreement of even date herewith, among Agents, Banks, and Borrower with respect to, among other things, certain representations and warranties of the Companies.

"Closing Certificate" means a Closing Certificate substantially in the form of Exhibit E.

"Closing Date" means each date on which Loans are made.

"Commitment Reduction Amount" has the meaning stated in Section 3.1(b)(i).

"Commitment Reduction Date" means the last Business Day of each February, May, August and November, commencing with the last Business Day of November 1980, to and including the Termination Date.

"Companies" means Borrower and all of its Subsidiaries.

"Consolidated Cash Flow from All Operations" for any period means, on a consolidated basis, all cash received by the Companies (other than the Partnership) (or, if for a future period, all cash projected to be received) from all sources (or, if for a future period, from on going and continuous operations) during the period in question, minus (a) all cash disbursements which the Companies (other than the Partnership) are obligated to pay to other Persons (other than Annual Required Debt Service and other than amounts which have been theretofore accrued under (d) following) during such period, (b) all payments on the Hunt Notes, (c) all revenues and distributions under the Partnership Agreement, and (d) all reasonable amounts which, under normal operating procedures (taking into account historical accruals by the Companies), should be added to reserves for future payments (such as reserves for interest and Taxes), all of the foregoing to be determined in accordance with GAAP.

"Crescent" means Crescent Investment Company, a Delaware corporation and a wholly-owned subsidiary of Borrower.

"Debt" means the sum of (i) all indebtedness for money borrowed or for the deferred purchase price of property (other than trade payables incurred in the ordinary course of business), plus (ii) the unborrowed portion of loan commitments, plus (iii) direct and indirect guaranties with respect to indebtedness for borrowed money or for the deferred purchase price of property (other than trade payables incurred in the ordinary course of business and other than guaranties of the Noordgastransport Debt), plus (iv) the present value (using a discount factor of 20% through December 31, 1980, and 15% after December 31, 1980) of all obligations for rentals under leases and subleases of real and/or personal property (other than Hydrocarbon leases, drilling rig leases or contracts, and leases of office space and office equipment for use by the Companies in their operations), of longer than one year which, in the aggregate, exceed $100,000, plus (v) indebtedness for borrowed money or for the deferred purchase price of property (other than trade payables incurred in the ordinary course of business), in effect guaranteed by means of a throughput, working capital maintenance, take or pay, or other agreement having similar effect (other than obligations with respect to the Noordgastransport Debt), plus (vi) "production payments", advance payments, and similar interests to which any Hydrocarbon Properties are subject and Debt created in connection therewith.

"Debtor Relief Laws" means all applicable liquidation, conservatorship, bankruptcy, moratorium, rearrangement, insolvency, reorganization, or similar debtor relief Laws affecting the Rights of creditors generally from time to time in effect.

"Default" has the meaning stated in Section 8.

"Demand Notes" means (i) the promissory notes dated April 8, 1980 in the aggregate principal amount of $300,000,000 executed and delivered by Borrower and (ii) any additional notes which may be hereafter executed and delivered by Borrower (with written notice to Agents) to some or all of the Banks to evidence advances which may be made (but which no Bank shall be obligated to make) on an interim basis prior to the initial Loans under this Agreement.

"Determination Date" means a date as of which a computation, calculation, or determination is made hereunder.

"Distribution" by any Person, means (a), with respect to any Equity Securities issued by such Person, the retirement, redemption, purchase, or other acquisition for value of any such Equity Securities, (b) the declaration or payment of any dividend or other distribution on or with respect to any such Equity Securities (other than a dividend or distribution by a Subsidiary to an Obligor), (c) any loan or advance by such Person to, or other investment by such Person in, the holder of any of such Equity Securities or an Insider, and (d) any other payment (other than salaries of employees or advances made in the ordinary course of business to employees for travel and other expenses incurred in the ordinary course of business) by such Person with respect to Equity Securities, or to an Insider.

"Dollars" or the symbol "$" means lawful currency of the United States of America.

"DSM Debt" has the meaning stated in Section 7.1(a).

"Engineered Properties" means Proved Developed Producing Reserves with respect to which an Approved Engineer has reviewed and certified a report.

"Equity Securities" means (i) capital stock or other equity rights, bonds, notes, or other instruments convertible into capital stock or other equity rights; and options, warrants, or other rights to acquire capital stock or other equity rights and (ii) any partnership interest.

"Exhibit" means an exhibit attached to the Closing Agreement, unless specifically indicated otherwise.

"Existing Debt" has the meaning stated in Section 8.4(b).

"Financial Statements" includes, but is not limited to, balance sheets, profit and loss statements, reconciliations of capital and surplus, statements of changes in financial position, and schedules of sources and applications of funds, all prepared in comparative form with respect to the corresponding period of the preceding fiscal year and in accordance with GAAP.

"First Closing Date" means the date on which the initial Loans are made.

"First in Dallas" means First National Bank in Dallas.

"Foreign Bank" has the meaning stated in Section 7.1(f).

"Future Net Revenue from Engineered Properties," on any Determination Date, means the projected revenue attributable to the interests of one or more Obligors in Engineered Properties which Obligors can reasonably expect to receive from the sale of Hydrocarbons therefrom, as shown on the most current reports thereon by Approved Engineers, minus production and severance taxes (including without limitation any "windfall profits" or similar tax), royalties, and cash production expenses and investment, and minus the amount of all production revenue therefrom from the dates of such reports to the Determination Date.

"GAAP" means generally accepted accounting principles, applied on a consistent basis, set forth in Opinions of the Accounting Principles Board of the American Institute of Certified Public Accountants and/or in statements of the Financial Accounting Standards Board which are applicable in the circumstances as of the date in question; and the requisite that such principles be applied on a consistent basis means that the accounting principles in a current period are comparable in all material respects to those applied in the next preceding period (or, for determination of compliance with Section 6.7(a), comparable in all material respects to those applied in preparing the Financial Statements for the year ended December 31, 1979).

"General Partner" means Placid Investment Company, a Delaware corporation which is a wholly owned Subsidiary of Borrower and the general partner of the Partnership.

"Guaranty" means a guaranty in the form of Exhibit A (for any Company organized under the Laws of a state of the United States) or Exhibit B (for any Company organized under the Laws of a country other than the United States), modified in a manner satisfactory to Agents to comply with any Laws.

"Highest Lawful Rate," for each Bank, means the maximum rate of interest which such Bank is allowed from time to time to contract for, charge, take, reserve, or receive under applicable Laws after taking into account, to the extent required by applicable Laws, any and all relevant payments, fees, or charges under the Loan Papers.

"Hunt Collateral" means the assets of the Hunts securing their obligations under the Hunt Guaranty, the Partnership Agreement and the Hunt-Placid Loan Agreement, in that order of priority.

"Hunt Commitment" means the obligation of the Hunts to make additional capital contributions to the Partnership as required by the Partnership Agreement.

"Hunt Guaranty" means a guaranty substantially in the form of Exhibit Y, executed and delivered by the Hunts.

"Hunt Notes" means the following promissory notes: (i) the secured demand note dated April 5, 1980 of the Hunts payable to Borrower pursuant to the Hunt-Placid Loan Agreement in the aggregate principal amount of up to $800,000,000 and (ii) the secured promissory notes issued severally by the Hunts to the order of The First National Bank of Chicago and purchased by Borrower on April 8, 1980 for $101,454,026.34.

"Hunt-Placid Loan Agreement" means the loan agreement dated April 5, 1980, among Borrower, as lender, and the Hunts, as borrowers, as the same may be amended or restated from time to time in accordance with this agreement.

"Hunts" means Nelson Bunker Hunt, William Herbert Hunt, and Lamar Hunt, and their respective heirs, legal representatives, successors and assigns.

"Hydrocarbon Properties" means interests of the Companies (a) in Hydrocarbons prior to severance, and in leases, licenses, and other contracts or arrangements granting interests in Hydrocarbons or proceeds of Hydrocarbons prior to severance and (b) in partially or completely undeveloped acreage (onshore or offshore), and in leases, licenses, and other contracts or arrangements granting rights to explore for Hydrocarbons on or under partially or completely undeveloped acreage.

"Hydrocarbon Related Assets" means tangible personal property used in connection with exploration and development of, and production and transportation of Hydrocarbons from, Hydrocarbon Properties.

"Hydrocarbons" means oil, gas, and other liquid and gaseous hydrocarbons.

"Immediately Available Funds" means Federal or other funds immediately available for use in New York City.

"Insider" means any Person (other than Placid and its Subsidiaries) who (i) directly or indirectly owns, or who is a beneficiary of any trust which directly or indirectly owns, or who is an Affiliate of any Person who directly or indirectly owns, any legal or beneficial interest in any of the Companies, or (ii) is a director or officer of any of the Companies, or (iii) is a relative of any of the Persons described in the foregoing.

"Intercompany Debt" has the meaning stated in Section 6.4(c).

"Investments" means (a) loans or advances to, or investments in, or acquisition of any interest in, any Person, or (b) investments in or acquisitions of assets in which an Affiliate owns an interest to the extent the price or amount thereof exceeds a price or amount which would have been paid for a similar investment in or acquisition of assets owned by a non-Affiliate, or (c) acquisition of any assets other than Hydrocarbon Assets.

"Laws" means all applicable statutes, laws, executive orders, ordinances, regulations, orders, writs, injunctions, rulings, or decrees of the United States or of any state, commonwealth, nation, territory, possession, county, parish, municipality, or Tribunal.

"Lien" means any lien, mortgage, security interest, charge, or encumbrance of any kind, including, without limitation, the rights of a vendor, lessor, or similar party under any conditional sale agreement or other title retention agreement or lease substantially equivalent thereto, any production payment, advance payment or similar interests, and any other right of or arrangement with any creditor to have his claim satisfied out of any property or assets, or the proceeds therefrom, prior to the general creditors of the owner thereof.

"Litigation" means any proceeding, claim, lawsuit, and/or investigation conducted or threatened by or before any Tribunal.

"Loan Papers" means this agreement, the Closing Agreement, the Hunt Guaranty, the Partnership Agreement, the Pledge Agreements, and all promissory and other notes, mortgages, deeds of trust, security agreements, assignments, and other agreements, documents, instruments, and certificates ever delivered pursuant to the terms hereof, and any future amendments hereto or restatements hereof, or pursuant to the terms of the Closing Agreement or any of the other Loan Papers, and any and all present and future amendments to, and renewals, extensions, modifications, and restatements of, any of the foregoing.

"Loans" means Loans made pursuant to Section 3.1.

"Majority Banks" means, at any time, Banks holding at least 66 2/3% of the Total Principal Debt, or, if no Principal Debt is at the time outstanding, Banks having at least 66 2/3% of the aggregate amount of the Total Committed Sum.

"Margin Debt" means Debt owed to stock brokerage companies referred to in Section 6.4(b)(viii).

"Margin Stock" means "margin stock", as that term is defined in Regulation U.

"Material Adverse Effect" means any circumstances, events, or state of facts which (i) could have any adverse effect whatsoever upon the validity or enforceability of any Loan Papers, or (ii) are, will be, or are expected to be material and adverse to the assets, financial condition or business operations of the Companies, or (iii) impair, or will or are expected to impair, the ability of the Companies to fulfill their obligations under the Loan Papers, or (iv) cause, or will or are expected to cause, a Default or a Potential Default.

"Material Agreement" of any Person means any material written or oral agreement, contract, commitment, or understanding to which such Person is a party, by which such Person is directly or indirectly bound, or to which any assets of such Person may be subject, which is not cancellable by such Person upon notice of 90 days or less without liability for further payment other than nominal penalty.

A "month" means a calendar month.

"Morgan" means Morgan Guaranty Trust Company of New York.

"Mortgaged Hydrocarbon Properties" has the meaning stated in Section 7.1(a)(i).

"Mortgaged Properties" means the properties of the Companies described in Section 7.1(a) and any other properties, assets or rights of the Companies designated by Majority Banks in accordance with Section 7.1(b).

"1979 Loan Agreement" means the $450,000,000 Amended and Restated Loan Agreement dated as of November 30, 1979, among Placid, PIOL, Morgan, First in Dallas, and 18 other banks, and/or the $450,000,000 loan agreement contemplated by Section 4(m) of the Closing Agreement which is proposed to be entered into to repay amounts outstanding thereunder, as the same may be amended and/or restated from time to time.

"1979 Obligation" means the "Obligation" as defined in the 1979 Loan Agreement.

"1979 Principal Debt" means the "Principal Debt" as defined in the 1979 Loan Agreement.

"Noordgastransport" means Noordgastransport B.V., a Netherlands corporation of which PIOL owns 60% of the equity interest.

"Noordgastransport Debt" has the meaning stated in Section 6.4(b)(1).

"Notes" means Notes in the form of Exhibit D, evidencing the Loans, executed and delivered pursuant to Section 3.3.

"Obligation" means all indebtedness, obligations, and liabilities of Borrower under or arising pursuant to the Loan Papers.

"Obligors" means Borrower and each wholly-owned Subsidiary which has executed a valid and binding Guaranty.

"Officer's Certificate" means a certificate, executed by the Chairman of the Board, President, or principal financial officer of Borrower, substantially in the form of Exhibit C but containing such other certifications, statements, calculations, explanations, and conclusions as Agents may reasonably request with respect to compliance with any or all of the covenants and conditions contained in the Loan Papers.

"Other Bank Obligation" means (i) amounts outstanding from time to time under the Demand Notes, (ii) amounts outstanding to Borrower under working capital lines of credit extended by Morgan Guaranty Trust Company of New York, The Chase Manhattan Bank (National Association) and Manufacturers Hanover Trust Company, in the maximum principal amount of $10,000,000 for each such Bank, (iii) that certain promissory note dated March 17, 1980 of Borrower payable to the order of Bankers Trust Company in the principal amount of $50,000,000 and (iv) that certain demand promissory note dated March 31, 1980 of Borrower payable to the order of Citibank, N.A. in the original principal amount of $25,000,000, under which $15,000,000 in principal amount is currently outstanding.

"Partnership" shall mean the limited partnership between General Partner and the Hunts formed as provided in the Partnership Agreement.

"Partnership Account" has the meaning stated in Section 7.2.

"Partnership Agreement" means a limited partnership agreement between General Partner and the Hunts substantially in the form of Exhibit E.

"Partnership Debt" means "Partnership Debt" as defined in the Partnership Agreement, to which Debt assets transferred to the Partnership shall be subject, but which Debt shall not be assumed by the Partnership.

"Permitted Debt" has the meaning stated in Section 6.4.

"Permitted Liens" has the meaning stated in Section 6.6.

"Permitted Nonrecourse Secured Debt" has the meaning stated in Section 6.4(e).

"Person" means any individual, firm, trust, corporation, association, partnership, joint venture, other entity, or Tribunal.

"PIOL" means Placid International Oil, Ltd., a Delaware corporation and a wholly owned subsidiary of Borrower.

"Placid Refineries" means the refineries referred to in Section 7.1(a)(i)(B).

"Pledge Agreements" means (i) the General Pledge Agreement dated as of April 28, 1980 among Borrower, Crescent and Agents relating to the pledge of the stock of all Subsidiaries of Borrower and Crescent except the General Partner; (ii) the Special Pledge Agreement dated as of April 28, 1980 among Borrower and Agents relating to the pledge of the stock of the General Partner and the Hunt Notes; (iii) the Partnership Pledge Agreement dated as of April 28, 1980 among Borrower, General Partner and Agents, relating to the pledge of the interest of General Partner in the Partnership; and (iv) the Auxiliary Pledge Agreement dated as of April 28, 1980 between Borrower and Agents relating to the pledge of all Equity Securities of Paloma Pipeline Company owned by the Companies.

"Potential Default" means the occurrence of any event or existence of any state of facts which, with notice or lapse of time or both, would become a Default.

"Prime Rate" means the rate of interest publicly announced by Morgan in New York City from time to time as its Prime Rate, such rate to be adjusted automatically on and as of the effective date of any change in the Prime Rate.

"Principal Debt" for each Bank, means, on any Determination Date, the unpaid principal balance of the Note payable to such Bank.

"Pro Rata Part", for each Bank, (a) through the Termination Date, means the proportion which such Bank's portion (as stated on Schedule One) of the initial Total Committed Sum of $1,100,000,000 bears to $1,100,000,000, and (b) thereafter means the proportion which the Principal Debt owed to such Bank on the Determination Date bears to the Total Principal Debt on the Determination Date.

"Proved Developed Producing Reserves" means the interests of Obligors in quantities of Hydrocarbons which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years with existing equipment and operating methods from completion intervals open for production on the Determination Date in existing wells, except that (i) properties securing Permitted Nonrecourse Secured Debt shall be excluded, (ii) properties located outside the United States of America, Canada, and the Netherlands Sector of the North Sea shall be excluded to the extent they contribute more than 5% of Future Net Revenue of all Engineered Properties, and (iii) other proved developed Hydrocarbon Properties capable of immediate production but which are not, for some reason, presently producing, may be included to the extent they do not contribute more than 5% of the Future Net Revenue of all Engineered Properties.

"Qualified Forward and Future Sale Transaction" means a transaction entered into by the Partnership for the purpose and with the intent of facilitating the orderly disposition of its silver position and which is either a Qualified Forward Sale Transaction or a Qualified Future Sale Transaction.

"Qualified Forward Sale Transaction" shall mean a transaction pursuant to a contract for the forward cash sale of silver by the Partnership with respect to which at the delivery date provided for therein the Partnership will tender, and intends and expects to deliver, silver to the buyer and the buyer agrees to take delivery of silver from the Partnership at the price and in the quantity provided for therein.

"Qualified Future Sale Transaction" shall mean a transaction for the sale of a futures contract for silver with respect to which on or prior to the delivery date provided for therein the Partnership will (i) both sell in the cash market a number of troy ounces of silver equal to the number of troy ounces the sale of which is provided for in the futures contract and immediately close out the related futures contract sold, or (ii) "roll over" the futures contract sold so as to defer the delivery date provided for therein without increasing the quantity of silver sold therein or decreasing the sales price, or (iii) tender delivery of silver against the futures contract sold, provided that this sentence shall in no event be construed to permit any transaction or position which is not a bona fide hedging transaction or position as such terms may be defined from time to time in the Commodity Exchange Act, as amended, and the rules and regulations promulgated thereunder.

"Regulation D" means Regulation D of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

"Regulation T" means Regulation T of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation relating to margin or other requirements for loans by brokers or dealers for the purpose of purchasing or carrying securities.

"Regulation U" means Regulation U of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation relating to margin or other requirements for loans by domestic banks for the purpose of purchasing or carrying Margin Stock.

"Rights" means rights, remedies, powers, and privileges.

"Schedules" means schedules attached to this agreement.

"Sections" means Sections of this agreement, unless specifically indicated otherwise.

"Subsidiary" means, on any Determination Date, any Person (other than Noordgastransport but including the

Partnership) an aggregate of 80% or more of the Equity Securities of any class or classes (or equivalent interests) of which is then owned of record or beneficially, or controlled, directly or indirectly, by Borrower, if the holders of the Equity Securities of such class or classes (or equivalent interests) (i) are ordinarily, in the absence of contingencies, entitled to vote for the election of a majority of the directors (or individuals performing similar functions) of such Person, even though the right so to vote has been suspended by the happening of such a contingency, or (ii) are entitled, as such holders, to vote for the election of a majority of the directors (or individuals performing similar functions) of such Person, whether or not the right so to vote exists by reason of the happening of a contingency.

"Taxes" means all taxes, assessments, fees, levies, imposts, duties, deductions, withholdings, or other charges of any nature whatsoever from time to time or at any time imposed by any Law or Tribunal.

"Termination Date" shall be as stated in Section 3.1.

"Total Committed Sum" shall be as stated in Section 3.1.

"Total Principal Debt" means, on any Determination Date, the aggregate unpaid principal balance of all Notes.

"Total Required Debt Service" means the sum of projected required principal and interest payments on Debt (other than principal and/or interest payments excluded as provided in Section 6.4(f)) of the Companies, based upon the assumption that the annual interest rate on all Debt (other than Debt with a rate fixed throughout the term of such Debt) will be 20% through December 31, 1980, and 15% after December 31, 1980, unless it reasonably appears to Agents that actual interest rates will be materially different from those indicated, in which case rates specified by Agents (or, if Majority Banks object to rates so specified, rates specified by Majority Banks) will be utilized.

"Tribunal" means any court or government department, commission, board, bureau, agency, or instrumentality of the United States or of any state, commonwealth, nation, territory, possession, county, parish, or municipality, whether now or hereafter constituted and/or existing.

A "year" means a calendar year.

SECTION 10. The Agents.

10.1 Appointment and Authority. Each Bank, and each subsequent holder of any Note by its acceptance thereof, (a) irrevocably authorizes Morgan, and Morgan hereby undertakes, to receive payments of principal, interest, and other amounts due hereunder as specified herein and (b) irrevocably authorizes each Agent, and each Agent hereby undertakes to take all other actions on behalf of such Bank or such holder and to exercise such powers under the Loan Papers as are specifically delegated to such Agent by the terms thereof, together with all other such powers as shall be reasonably incidental thereto. The relationship between each Agent and Banks is and shall be that of principal and agent only, and nothing herein shall be construed to constitute either Agent a trustee for a holder of any of the Notes or of a participation therein nor to impose on either Agent duties and obligations other than those expressly provided for herein. Neither of the Agents nor any of their directors, officers, employees, or agents shall be liable for any action lawfully taken or omitted to be taken by it or them under any of the Loan Papers or in connection therewith, except for its own or their own gross negligence or willful misconduct. Each Bank, and each subsequent holder of any of the Notes by its acceptance thereof, agrees to indemnify, in the proportion which the outstanding principal amount of the Note held by it bears to the Total Principal Debt (or if the Notes are not outstanding, to the extent of its Pro Rata Part), each Agent (to the extent not reimbursed by Borrower) from and against any and all losses, claims, damages, liabilities, and expenses which may be imposed on, incurred by, or asserted against either Agent in any way related to or arising out of its status as Agent under any of the Loan Papers, except any such losses, claims, damages, liabilities, or expenses resulting from the gross negligence or willful misconduct of such Agent.

10.2 Agents May Rely on Documents. Each Agent shall be entitled to rely on any communication, instrument, or documents believed by it to be genuine and correct and to have been signed or sent by the proper person or persons and with respect to all legal matters shall be entitled to rely on opinions of legal advisors selected by it concerning all matters relating to the Loan Papers and its duties thereunder, and shall not be liable to any of the parties hereto for the consequences of such reliance in good faith.

10.3 No Amendment to Agents' Duties Without Consent. Neither Agent shall be bound by any waiver, amendment, supplement, or modification of any Loan Papers which affects its duties thereunder unless it shall have given its prior written consent as Agent thereto.

10.4 Responsibilities of Agents. Agents may treat the payee of any of the Notes as the holder thereof until written notice of the transfer thereof shall have been received by them. Agents shall not be responsible to Banks for the validity, effectiveness, enforceability, or sufficiency of any of the Loan Papers.

10.5 Agents Shall Have Rights of a Bank. In relation to their commitment hereunder and their Notes, Agents shall have the same Rights and obligations hereunder as any Bank and may exercise such Rights and shall perform such obligations as though they were not Agents.

10.6 Sharing of Set-Offs and Other Payments. Each Bank agrees that, if it shall, whether through the exercise of a right of banker's lien, set-off, or counterclaim against the Companies, by reason of realization upon any collateral for the Loans, including, without limitation, with respect to the Hunt Collateral or otherwise, obtain payment of a proportion of the aggregate indebtedness to it hereunder which is greater than the proportion of such indebtedness to any other Bank being paid simultaneously, it shall be deemed to have simultaneously purchased and shall be obligated to purchase from such other Bank an interest in such indebtedness held by such other Bank, and such other adjustments shall be made from time to time as shall be equitable, in order to ensure that such Bank shares such payment pro rata; provided, however, that nothing herein contained shall in any way affect the right of any Bank to obtain payment (whether by exercise of right of banker's lien, set-off or counterclaim or otherwise) of indebtedness other than indebtedness hereunder. The Companies expressly consent to the foregoing arrangements and agree that any holder of any such interest or other participation in such indebtedness, whether or not acquired pursuant to the foregoing arrangements, may, to the fullest extent permitted by Law, exercise any and all rights of banker's lien, set-off, or counterclaim as fully as if such holder were a holder of such indebtedness in the amount of such interest or other participation.

SECTION 11. Miscellaneous.

11.1 Notices. Except as set forth below, all notices hereunder shall be in writing and shall be deemed to have been given when delivered in person or telexed, cabled, or telegraphed (with confirmation by mail) addressed, if to any Bank, at its address set forth in Schedule One hereof; if to First in Dallas, as Agent, at its office at 1401 Elm Street, Dallas, Texas 75283, Attention: Multinational Energy Department; if to Morgan, as Agent, c/o Morgan Guaranty Trust Company of New York, 23 Wall Street, New York, New York 10015, Attention: Petroleum Department; if to Borrower, at its office at 1600 First National Bank Building, Dallas, Texas 75202, Attention: Treasurer; or to any party hereto at any other address of which such party shall have notified the Person giving such notice in writing. Agents shall use reasonable efforts to give Borrower timely notice (which notice may be oral, telephonic or in writing) of the amounts of interest and fees payable by it from time to time hereunder; provided, however, that the failure to give such notice shall not affect the obligations of Borrower to pay interest and fees hereunder when due.

11.2 Headings. The headings, captions, arrangement of provisions, and table of contents used in any of the Loan Papers are, unless specified otherwise, for convenience only and shall not be deemed to limit, amplify, or modify the terms of the Loan Papers, nor affect the meaning thereof.

11.3 Exhibits. If any exhibit, which is to be executed and delivered, contains blanks, the same shall be completed correctly and in accordance with the terms and provisions contained and as contemplated herein prior to or at the time of the execution and delivery thereof.

11.4 Number and Gender of Words. Whenever in any Loan Papers the singular number is used, the same shall include the plural where appropriate, and vice versa; and words of any gender shall include each other gender where appropriate.

11.5 Form and Number of Documents. Each agreement, document, instrument, or other writing to be furnished to Banks under any provision of this agreement must be in form and substance and in such number of counterparts as may be satisfactory to Agents and their counsel.

11.6 Survival. All covenants, agreements, undertakings, representations, and warranties made in any of the Loan Papers shall survive all closings under the Loan Papers and shall not be affected by any investigation made by any party.

11.7 Waivers. The acceptance by any Bank at any time and from time to time of part payment on the Obligation shall not be deemed to be a waiver of any Default then existing. No waiver by any Bank of any Default shall be deemed to be a waiver of any other then existing or subsequent Default. No delay or omission by any Bank in exercising any Right under the Loan Papers shall impair such Right or be construed as a waiver thereof or an acquiescence in any such Default, nor shall any single or partial exercise of any such Right preclude any other or further exercise thereof, or the exercise of any other Right under the Loan Papers or otherwise. No waiver by any Bank shall be deemed to be a waiver by any other Bank, except to the extent provided in Section 11.12.

11.8 Cumulative Rights. All Rights available to Banks under the Loan Papers shall be cumulative of and in addition to all other Rights granted to Banks at law or in equity, whether or not the Obligation is due and payable and whether or not Banks shall have instituted any suit for collection or other action in connection with the Loan Papers.

11.9 Expenditures by Bank. Any sums spent by any Bank pursuant to the exercise of any Right after Default shall become part of the Obligation and shall bear interest at the rate specified in Section 3.5(b) from the date spent until the date repaid by Borrower.

11.10 Indemnification of Banks. Borrower, and each Subsidiary executing and delivering a Guaranty, jointly and severally agree to indemnify each Bank and hold each Bank harmless from and against any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, claims, costs, expenses, and disbursements of any kind or nature whatsoever which may be imposed on, incurred by, or asserted against such Bank (or which may be imposed on, incurred by, asserted against either Agent at any time in connection with performance of its duties as Agent hereunder), in any way relating to or arising out of the Loan Papers or any of the transactions contemplated therein; provided that no Bank shall have the Right to be indemnified hereunder for its own gross negligence or willful misconduct.

11.11 Maximum Interest Rate. Regardless of any provision contained in any of the Loan Papers, no Bank shall ever be entitled to receive, collect, or apply, as interest on the Obligation, any amount in excess of the Highest Lawful Rate, and, in the event any Bank ever receives, collects, or applies as interest, any such excess, such amount which would be excessive interest shall be deemed a partial repayment of principal amount of such Bank's Note and treated hereunder as such; and, if the principal amount of such Bank's Note is paid in full, any remaining excess shall forthwith be paid to Borrower. In determining whether or not the interest paid or payable, under any specific contingency, exceeds the Highest Lawful Rate, the Companies and each Bank agree that, to the maximum extent permitted under applicable Law, (i) any nonprincipal payment shall be characterized as an expense, fee, or premium rather than as interest, (ii) voluntary prepayments and the effects thereof shall be excluded, (iii) the total amount of interest shall be amortized, prorated, allocated and spread, in equal parts, throughout the entire contemplated term of the Obligation so that the interest rate is uniform throughout the entire term of the Obligation, and (iv) if the Obligation is paid and performed in full prior to the end of the full contemplated term thereof and if the interest received by any Bank for the actual period of existence thereof exceeds the amount permitted at the Highest Lawful Rate, such Bank shall refund to Borrower the amount of such excess, and, in such event, such Bank shall not be subject to any penalties provided by any Laws for contracting for, charging, taking, reserving, or receiving interest in excess of the Highest Lawful Rate.

11.12 Modifications, Amendments, or Waivers.

(a) With the written consent of Majority Banks, Agents, acting on behalf of all Banks, and Borrower may from time to time enter into agreements amending or changing any provision of the Loan Papers or the rights of Banks or Borrower thereunder, or give waivers or consents to a departure from the due performance of the obligations of any Company under the Loan Papers, or release collateral. Any such agreement, waiver, or consent shall be effective to bind all the Banks; provided, that no such agreement, waiver, or consent may be made which will:

(i) Reduce or increase the amount or alter the term of any commitment of any Bank hereunder without the written consent of (i) such Bank, and (ii) in the case of a reduction, all Banks;

(ii) Extend the time for payment of principal or interest on any Note, or reduce the principal amount or the rate of interest on any Note, without the written consent of the holder of such Note;

(iii) Vary the amount or time for payment of fees payable to any Bank hereunder, without the written consent of such Bank; or

(iv) Change the percentage of 34% specified in the last paragraph of Section 8; or reduce the percentage of 66 2/3% specified in the definition of "Majority Banks", or amend this Section 11.12, without the written consent of all of the Banks.

(b) No such waiver or consent shall extend to any subsequent or other Potential Default or Default or impair any Right consequent thereto.

(c) Notwithstanding Section 11.12(a), Borrower shall be entitled to a release of collateral under the terms of Section 7.1(e) without the consent of Majority Banks.

11.13 Binding Effect, Assignment, and Participation. This agreement shall be binding upon and inure to the benefit of the Companies, the Agents, and each Bank and their respective successors and assigns; provided, that no Company shall have the Right to assign its rights under the Loan Papers without the prior written consent of all Banks; and provided further that, in the event the Bank shall exercise their rights pursuant to Section 4 of the Hunt Guaranty, then subsequent to their purchase of the Obligation the Hunts shall be subject to, and Borrower shall be entitled to enforce against them, the provisions of Sections 4.2 and 4.3(e) of the Hunt Guaranty and Section 6.7 of the Partnership Agreement.

11.14 Invalid Provisions. If any provision of any of the Loan Papers is invalid or unenforceable in any jurisdiction then, to the extent permitted by law, (a) the other provisions thereof shall remain in full force and effect in such jurisdiction and shall be liberally construed in favor of Banks in order to carry out the intentions of the parties hereto as nearly as may be possible; and (b) the invalidity or unenforceability of such provision in any jurisdiction shall not affect the validity or enforceability thereof in any other jurisdiction.

11.15 Entirety and Amendments. This instrument, the Closing Agreement, and the instruments, documents, and agreements delivered pursuant to this agreement or the Closing Agreement embody the entire agreement between the parties, supersede all prior agreements and understandings, if any, relating to the subject matter hereof, and may be amended only by an instrument in writing executed jointly by an authorized officer of Borrowers and Agents (with the consent of Majority Banks or of all Banks if such is required), and supplemented only by documents delivered or to be delivered in accordance with the express terms of the Loan Papers.

11.16 Right of Set-Off. If a Default (including any applicable grace period) shall have occurred and be continuing and Agents have declared the Notes to be (or the Notes have become) forthwith due and payable pursuant to Section 8, then each Bank is hereby authorized at any time and from time to time, without notice to the Companies (any such notice being expressly waived by the Companies), to set off and apply any and all deposits (general or special, time or demand, provisional or final) at any time held and other indebtedness at any time owing by such Bank to or for the credit or the account of any Company against any and all of the obligations of the Companies now or hereafter existing under the Loan Papers, irrespective of whether or not such Bank shall have made any demand under the Loan Papers and although such obligations may be unmatured. Each Bank agrees to use reasonable efforts to promptly notify Borrower and the other Banks after any such set-off and application made by such Bank, provided that the failure to give such notice shall not affect the validity of such set-off and application. The Rights of each Bank under this Section are in addition to other Rights (including, without limitation, other rights of set-off) which such Bank may have.

11.17 Representation by Banks. Each Bank hereby represents that it is making loans and acquiring its Notes for its own account in the course of its normal lending operations and not with a present view to reselling or granting a participation therein to any other person (subject to any requirement of law that the disposition of its property at all times be within its control). If a Bank subsequently makes a decision to sell its Notes or a participation therein, it will promptly notify Agents and Borrower of the identity of the assignee or participant and the amount involved.

11.18 Inconsistent Provisions. Provisions in any of the Loan Papers other than those specifically named in the definition of Loan Papers are inconsistent with provisions of this agreement, then the relevant provisions of this agreement shall control.

11.19 Multiple Counterparts. This agreement has been executed in a number of identical counterparts, each of which shall be deemed an original for all purposes and all of which constitute, collectively, one agreement; but in making proof of this agreement, it shall not be necessary to produce or account for more than one such counterpart. It is not necessary for all Banks to sign all counterparts, and it shall be sufficient if each party shall have signed at least one counterpart.

11.20 Consent to Jurisdiction; Service of Process. Each of the Obligors irrevocably submits to the jurisdiction of any New York State or federal court sitting in The City of New York over any suit, action, or proceeding arising out of or relating to any of the Loan Papers. Each of the Obligors irrevocably waives, to the fullest extent permitted by Law, any objection which it may have or hereafter have to the laying of the venue of any such suit, action or proceeding brought in such a court and any claim that any such suit, action or proceeding has been brought in an inconvenient forum. Each of the Obligors designates and appoints CT Corporation System, 277 Park Avenue, New York, New York 10017, as its authorized agent to accept and acknowledge on its behalf service of any and all proceedings of the nature referred to in the first sentence of this Section. Each of the Obligors represents and warrants that CT Corporation System has agreed in writing to accept such appointment and that a true copy of such acceptance has been furnished to Agents. If such agent shall cease to act for any reason whatsoever, each of the Obligors covenants and agrees that it will designate and appoint without delay another such agent satisfactory to Agents and will promptly deliver to Agents evidence in writing of such other agent's acceptance of such appointment. Each of the Obligors consents to process being served in any suit, action, or proceeding of the nature referred to in the first sentence of this Section by either (i) the mailing of a copy thereof by registered or certified air mail, postage prepaid, return receipt requested, to the address of Borrower provided for in Section 11.1, or (ii) by serving a copy thereof upon CT Corporation System at its offices (presently located at 277 Park Avenue, New York, New York 10017) or any successor thereto or substitute therefor at its offices as the agent of the Obligors for service of process. Each of the Obligors agrees that such service (x) shall be deemed in every respect effective service of process upon such Obligor in any such suit, action, or proceeding and (y) shall, to the fullest extent permitted by Law, be taken and held to be valid personal service upon and personal delivery to such Obligor. Nothing in this Section shall affect the right of Agents, any Bank, or the holder of any Note to serve process in any manner permitted by law or limit the right of Agents, any Bank, or the holder of any Note to bring proceedings against any Obligor in the courts of any jurisdiction or jurisdictions.

11.21 Governing Law. This agreement has been executed and delivered in, and shall be governed by and construed in accordance with, the laws of the State of New York and the Federal laws of the United States of America. The Closing Agreement, each of the Notes and each other Loan Paper which does not by its terms provide to the contrary, shall be governed by and construed in accordance with the laws of the State of New York and the Federal laws of the United States of America.

Executed as of April 28, 1980.

PLACID OIL COMPANY

By: C D Brown
C.D. Brown, President

FIRST NATIONAL BANK IN DALLAS,
as a Bank and as an Agent

By: ______________________
John P. Lewis
Senior Vice President

CITIBANK, N.A.

By: ______________________
VP

BANK OF AMERICA NATIONAL
TRUST AND SAVINGS ASSOCIATION

By: ______________________
Vice President

CONTINENTAL ILLINOIS NATIONAL
BANK AND TRUST COMPANY OF
CHICAGO

By: ______________________

THE ROYAL BANK OF CANADA

By: ______________________
SVP

CHEMICAL BANK

By: ______________________
V.P.

MORGAN GUARANTY TRUST COMPANY
OF NEW YORK, as a Bank and
as an Agent

By: Thomas P Kellogg Jr
Thomas P. Kellogg, Jr.
Vice President

THE CHASE MANHATTAN BANK
(NATIONAL ASSOCIATION)

By: ______________________
Vice President

MANUFACTURERS HANOVER TRUST
COMPANY

By: ______________________
Vice President

CANADIAN IMPERIAL BANK OF
COMMERCE

By: ______________________
Asst. Manager

THE FIRST NATIONAL BANK OF
CHICAGO

By: ______________________
Vice President

BANKERS TRUST COMPANY

By: ______________________
Vice President

REPUBLIC NATIONAL BANK OF DALLAS

By: Robert L. Zorich
V.P.

SCHEDULE ONE

BANKS

BANKS, ADDRESS, AND OFFICER	COMMITTED SUM
First National Bank in Dallas 1401 Elm Street Dallas, Texas 75283 Attention: Mr. John P. Lewis	$ 10,000,000
Morgan Guaranty Trust Company of New York 23 Wall Street New York, New York 10015 Attention: Mr. Thomas P. Kellogg, Jr. Petroleum Department	$ 100,000,000
Citibank, N.A. Energy Systems Department 12th Floor 399 Park Avenue New York, New York 10043 Attention: Houston Energy Department	$ 200,000,000
The Chase Manhattan Bank (National Association) 1 Chase Manhattan Plaza New York, New York 10081 Attention: Petroleum Division	$ 150,000,000
Bank of America National Trust and Savings Association Corporate Service Center #1235 1000 West Temple Street Los Angeles, California 90012 Attention: Ms. Diane McCreary Account Administrator	$ 100,000,000
Manufacturers Hanover Trust Company 350 Park Avenue New York, New York 10022 Attention: Mr. P. Richard Gessinger	$ 100,000,000

Continental Illinois National Bank and Trust Company of Chicago 231 South LaSalle Street Chicago, Illinois 60693 Attention: Mr. A.J. Pearson Oil and Gas Division	$	80,000,000
Canadian Imperial Bank of Commerce Atlanta Agency 1400 First National Bank Tower 2 Peachtree Street, N.W. Atlanta, Georgia 30303 Attention:	$	75,000,000
The Royal Bank of Canada 76 William Street New York, New York 10005 Attention: Mr. Stewart A MacDonald	$	75,000,000
The First National Bank of Chicago One First National Plaza Chicago, Illinois 60670 Attention: Mr. William Lear Petroleum Division	$	70,000,000
Chemical Bank 277 Park Avenue New York, New York 10017 Attention: Mr. Donald L. Marsh, Jr.	$	50,000,000
Bankers Trust Company 280 Park Avenue New York, New York 10017 Attention: Mr. C. Lawrence Murphy	$	50,000,000
Republic National Bank of Dallas Pacific at Ervay Streets P.O. Box 225961 Dallas, Texas 75265 Attention: Robert L. Zorich Petroleum & Minerals Department	$	40,000,000
		$1,100,000,000

SCHEDULE TWO

Amortization Schedule

REVOLVING PERIOD

Last Business Day of	Commitment Reduction Amount	Commitment at End of Period (beginning amount $1.1 billion)
	($ millions)	
Nov. 80	6.0	1094
Feb. 81	16.5	1077.5
May 81	16.5	1061.0
Aug. 81	16.5	1044.5
Nov. 81	16.5	1028.0
Feb. 82	20.0	1008.0
May 82	20.0	988.0
Aug. 82	20.0	968.0
Nov. 82	20.0	948.0
Feb 83	20.25	927.75
May 83	20.25	907.50

TERM LOAN PERIOD

Installments Commencing August 31, 1983	Installment Amount*	Outstanding after last numbered installment*	Amortization Percentage (amortization per quarter as % of Total Principal Debt at close of business on the Termination Date)
	($ millions)		
Nos. 1-6	20.25	786.0	2.231%
7-10	30.5	664.0	3.361%
11-14	32.25	535.0	3.554%
15-18	33.75	400.0	3.719%
19-22	36.0	256.0	3.967%
23-26	43.75	81.0	4.821%
27-29	20.25	20.25	2.231%
No. 30	20.25	0	2.231%

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* Assuming maximum use of commitment on the Termination Date

SCHEDULE THREE

Mortgaged Hydrocarbon Properties

1. Prentice Field, Terry County, Texas.
2. Kelly Snyder Field, Scurry County, Texas.
3. East Texas Field, Rusk County, Texas.
4. Bassfield Field, Jefferson Davis County, Mississippi.
5. Oakvale Field, Jefferson Davis County, Mississippi.
6. North Choctaw Ridge Field, Choctaw County, Alabama.
7. Womack Hill Field, Clarke and Choctaw Counties, Alabama.
8. Prudhoe Bay Field, Barrow Recording District, Alaska.
9. Lucky Field, Bienville Parish, Louisiana.
10. Danville Field, Bienville Parish, Louisiana.
11. Black Lake Field, Natchitoches and Winn Parishes, Louisiana.
12. Olla Field, La Salle Parish, Louisiana.
13. Nebo-Hemphill Field, La Salle Parish, Louisiana.
14. West Catahoula Lake Field, La Salle Parish, Louisiana.
15. Catahoula Lake Field, La Salle Parish, Louisiana.
16. Patterson Field, St. Mary Parish, Louisiana.
17. Lapeyrouse Field, Terrebonne Parish, Louisiana.

18. Caillou Island Field, Terrebonne Parish, Louisiana.

19. Lake Washington Field, Plaquemines Parish, Louisiana.

20. Yo Yo Field, British Columbia.

21. Milligan Creek Field, British Columbia.

22. Sherwood Field, Saskatchewan.

23. Queensdale Field, Saskatchewan.

24. West Cameron 171 Field, Outer Continental Shelf ("OCS"), Louisiana.

25. South Marsh Island 269 Field, OCS, Louisiana.

26. Eugene Island 198, OCS, Louisiana.

27. Eugene Island 296, OCS, Louisiana.

28. Eugene Island 306, OCS, Louisiana.

29. Ship Shoal 207, OCS, Louisiana.

30. Ship Shoal 204, OCS, Louisiana.

31. N/2 and SE/4 of Ship Shoal 291, OCS, Louisiana.

32. L 10/11 Field, Dutch Sector, North Sea.

33. Chappell Hill Field, Choctaw County, Alabama.

34. Sugar Ridge Field, Choctaw County, Alabama.

35. Bucatunna Field, Choctaw County, Alabama.

36. Wimberly Field, Choctaw County, Alabama.

37. Dorcheat-Macedonia Field, Columbia County, Arkansas.

38. Magnolia Smackover Field, Columbia County, Arkansas.

39. Plainfield Field, Columbia County, Arkansas.

40. Shongaloo Red Rock Field, Columbia County, Arkansas.

41. Welcome Field, Columbia County, Arkansas.

42. Walker Creek Field, Columbia and Lafayette Counties, Arkansas.

43. McKamie Patton Field, Columbia and Lafayette Counties, Arkansas.

44. Mount Vernon Field, Columbia and Lafayette Counties, Arkansas.

45. Elbahoe Field, Arapahoe County, Colorado.

46. Nancy Field, Clarke County, Mississippi.

47. Quitman Field, Clarke County, Mississippi.

48. Dry Creek Field, Franklin County, Mississippi.

49. Pinewoods Field, Rankin County, Mississippi.

50. Middle Smackover Oil Pool Unit, Tallahala Field, Smith County, Mississippi.

51. Tule Creek Field, Roosevelt County, Montana.

52. Newburg Field, Bottieau County, North Dakota.

53. Sherwood Field, Renville County, North Dakota.

54. Elmore Field, Renville County, North Dakota.

55. Burmah Unit Area Field, Custer County, Oklahoma.

56. Slocum North Field, Anderson County, Texas.

57. Furhman-Mascho-Nix Field, Andrews County, Texas.

58. Fulton Field, Aransas County, Texas.

59. Water Valley Field, Coke, Sterling and Tom Green Counties, Texas.

60. Bronte Field, Coke County, Texas.

61. High Island Field, Chambers and Galveston Counties, Texas.

62. Eppenauer Field, Crane County, Texas.

63. Franks and Alma Lomat Orchard, Galveston County, Texas.

64. Sprayberry Driver Field, Glasscock County, Texas.

65. SMS (Canyon Sand) Field, Kent County, Texas.

66. Bethany Field, Panola County, Texas.

67. Damascus Field, Park County, Texas.

68. Cree-Sykes Unit, Runnels County, Texas.

69. Tompkin Field, Stonewall County, Texas.

70. Sugar Creek Field, Tyler County, Texas.

71. Quitman Field, Wood County, Texas.

72. Coteau Irene Field, Assumption Parish, Louisiana

73. Castor Field, Bienville Parish, Louisiana.

74. Liberty Hill Field, Bienville Parish, Louisiana.

75. Sailes Field, Bienville Parish, Louisiana.

76. Elm Grove Field, Bossier Parish, Louisiana.

77. Caterville Field, Bossier and Webster Parishes, Louisiana.

78. Sligo Field, Bossier Parish, Louisiana.

79. East Haynesville Field, Claiborne Parish, Louisiana.

80. Leatherman Creek Field, Claiborne Parish, Louisiana.

81. North Shaw Field, Concordia Parish, Louisiana.

82. Bethany-Longstreet Field, Desoto Parish, Louisiana.

83. Holly Field, Desoto Parish, Louisiana.

84. Chatham Field, Jackson Parish, Louisiana.

85. Clear Branch Field, Jackson Parish, Louisiana.

86. Chocahoula Field, La Fourche Parish, Louisiana.

87. Little Creek Field, La Salle Parish, Louisiana.

88. Rogers Field, La Salle Parish, Louisiana.

89. Searcy Field, La Salle Parish, Louisiana.

90. Summerville Field, La Salle Parish, Louisiana.

91. Trout Creek Field, La Salle Parish, Louisiana.

92. Tullos-Urania Field, La Salle Parish, Louisiana.

93. West Searcy Field, La Salle Parish, Louisiana.

94. Delhi Field, Madison and Richland Parishes, Louisiana.

95. Shuteston Field, St. Landry Parish, Louisiana.

96. South Chauvin Field, Terrebonne Parish, Louisiana.

97. Cotton Valley Field, Webster Parish, Louisiana.

98. North Shangaloo-Red Rock Field, Webster Parish, Louisiana.

99. South Sarepta Field, Webster Parish, Louisiana.

100. Calvin Field, Winn Parish, Louisiana.

101. Ship Shoal 205, OCS, Louisiana.

102. Ship Shoal 216, OCS, Louisiana.

103. Ship Shoal 290, OCS, Louisiana.

104. Eugene Island 199, OCS, Louisiana.

105. South Marsh Island, 268, OCS, Louisiana.

106. Vermileon Area 182, OCS, Louisiana.

107. South Marsh Island 281, OCS, Louisiana.

108. Various other rights-of-way, easements, servitudes, licenses, permits, leases, subleases, and appurtenances affecting Hydrocarbon Properties situated in St. Martin, Iberia, St. Mary, Jefferson, Terrebonne, Iberville, La Fourche, Plaquemines, Pointe Coupee, St. Landry and Assumption Parishes, Louisiana.

109. Hunt-Ferrin 14-12 Field, Alberta.

110. Almeda Field, Saskatchewan.

111. North Autler Field, Saskatchewan.

112. Star Valley Field, Saskatchewan.

113. Glen Ewens Field, Saskatchewan.

114. Gillry Field, Alberta.

C. AGREEMENT OF LIMITED PARTNERSHIP OF PLACID INVESTMENTS, LTD., AND PLACID INVESTMENT COMPANY, NELSON BUNKER AND WILLIAM HERBERT HUNT, DATED APRIL 28, 1980

XECUTION COPY

AGREEMENT

OF

LIMITED PARTNERSHIP

OF

PLACID INVESTMENTS, LTD.

among

PLACID INVESTMENT COMPANY,
as General Partner

and

NELSON BUNKER HUNT,

WILLIAM HERBERT HUNT,

and

LAMAR HUNT,

as Limited Partners

* * *

Effective as of April 28, 1980

AGREEMENT OF LIMITED PARTNERSHIP OF PLACID INVESTMENTS, LTD.

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THE PARTNERSHIP INTERESTS EVIDENCED BY THIS AGREEMENT HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION OR THE SECURITIES COMMISSIONER OF TEXAS IN RELIANCE UPON EXEMPTIONS FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT OF 1933, AS AMENDED, AND THE SECURITIES ACT OF TEXAS. PARTNERSHIP INTERESTS MAY NOT BE SOLD, TRANSFERRED, OR ASSIGNED, OR A SECURITY INTEREST CREATED THEREIN, UNLESS THE PURCHASER, TRANSFEREE, ASSIGNEE, OR HOLDER OF SUCH SECURITY INTEREST COMPLIES WITH ALL STATE AND FEDERAL SECURITIES LAWS AND WITH THE LIMITATIONS ON THE TRANSFERABILITY OF PARTNERSHIP INTERESTS SET FORTH IN THIS AGREEMENT. TRANSFERABILITY OF PARTNERSHIP INTERESTS IS THEREFORE LIMITED, AND INVESTORS MUST BEAR THE ECONOMIC RISK OF THEIR INVESTMENT FOR AN INDEFINITE PERIOD OF TIME.

AGREEMENT OF
LIMITED PARTNERSHIP OF
PLACID INVESTMENTS, LTD.

This Agreement of Limited Partnership of Placid Investments, Ltd. is made and entered into as of the 28th day of April, 1980, by and among Placid Investment Company, a Delaware corporation, whose residence address is set forth on the signature page hereof, as general partner, herein called the "General Partner," and Nelson Bunker Hunt, William Herbert Hunt, and Lamar Hunt, whose respective residence addresses are set forth on the signature page hereof, as limited partners, herein called the "Limited Partners."

The parties hereto agree and state as follows:

1. **Definitions.**

1.1 "Act" means the Texas Uniform Limited Partnership Act.

1.2 "Aggregate Allocation Amount" as of the end of each calendar year with respect to a Limited Partner means (i) the sum of the amounts, if any, by which the Initial Position Gain exceeds the actual gain of Contributed Assets (contributed by such Limited Partner) sold (during such year and all prior years) by the Partnership less (ii) the sum of the amounts, if any, by which the Initial Position Loss exceeds the actual loss of Contributed Assets (contributed by such Limited Partner) sold (during such year and all prior years) by the Partnership and less (iii) the aggregate of gains, net of losses, if any, allocated to such Limited Partner pursuant to Section 8.1.2 hereof (in all prior years).

1.3 "Aggregate Pay Down" with respect to any Measurement Date means an amount equal to the sum of all of the commitment reduction amounts (pursuant to Section 3.1(b) of the Revolving Credit Agreement) and quarterly installments of principal (pursuant to Section 3.4 of the Revolving Credit Agreement), as the case may be, due on or before such date by Placid under the Multi-Bank Loan.

1.4 "Agreement" means this Agreement of Limited Partnership of the Partnership, as amended from time to time.

1.5 "Business Day" means a day (other than a Saturday or Sunday) on which commercial banks are open for business in New York, New York.

1.6 "Coal Carry Contribution" means the amounts of cash that are necessary or desirable to be paid by the Partnership from time to time in order to maintain and retain ownership of the Coal Properties, including, but not limited to, taxes, rents, royalties, and other carrying costs associated with the Coal Properties.

1.7 "Coal Properties" means that portion of the Contributed Assets described as coal properties on Exhibit B hereto.

1.8 "Code" means the Internal Revenue Code of 1954, as amended.

1.9 "Contributed Assets" means those assets more particularly described on Exhibit B hereto and those assets described on Exhibit K hereto that are ultimately contributed to the Partnership pursuant to Section 6.1.3 hereof.

1.10 "Contribution Note" has the meaning stated in Section 6.1.1 hereof.

1.11 "Deemed Contribution Value" with respect to any Contributed Asset means the amount set forth opposite such asset on Exhibit C hereto.

1.12 "FNBD" means First National Bank in Dallas, Dallas, Texas.

1.13 "General Partner" means the entity designated as "General Partner" in the first paragraph of this Agreement and any assignee thereof who shall become a General Partner or a substitute therefor as provided in Section 10 of this Agreement.

1.14 "General Partner's Investment" as of any particular date shall mean the total of all contributions to the capital of the Partnership by the General Partner as of such date pursuant to Section 6.2.1 hereof.

1.15 "General Partner's Aggregate Primary Preference" as of any particular date means the aggregate amount of the General Partner's Primary Preference computed from the date of the formation of the Partnership through the date in question.

1.16 "General Partner's Unpaid Primary Preference" as of any particular date means the excess of the General Partner's Aggregate Primary Preference as of such date over the aggregate amount of cash distributed to the General Partner pursuant to Section 8.2.1 hereof.

1.17 "General Partner's Unpaid Secondary Preference" as of any particular date means the amount required to be distributed to the General Partner on such date in order to provide to the General Partner an effective 26.1053% per annum rate of return or yield on the General Partner's Unrecovered Contribution computed by giving effect to the timing and amount of contributions to the capital of the Partnership by the General Partner pursuant to Section 6.2.1 hereof and after giving effect to the timing and amount of distributions to the General Partner pursuant to Sections 8.2.1, 8.2.3, 8.2.4, and 8.2.5 hereof.

1.18 "General Partner's Primary Preference" for any period means an amount equal to the product of the Primary Preference Rate (adjusted for the length of the period involved on the basis of a 365 day year) times the daily average outstanding balance of the General Partner's Unrecovered Contribution during such period.

1.19 "General Partner's Unrecovered Contribution" means the General Partner's Investment reduced by cash distributions to the General Partner from the Partnership pursuant to Sections 8.2.3 and 8.2.4 hereof.

1.20 "Hunt Brothers' Guaranty" has the meaning stated in Section 6.7 hereof.

1.21 "Hunt Brothers' Note" means, collectively, that certain promissory note dated April 5, 1980, in the original principal amount of $800,000,000, and with a principal balance of approximately $50,000,000 on the date of initial funding of the Multi-Bank Loan, from the Limited Partners payable to Placid and those three separate notes payable to The First National Bank of Chicago dated February 4, 1980, March 2, 1979, and March 2, 1979 in the respective principal amounts of $50,000,000, $35,000,000 and $15,000,000 and executed by Lamar Hunt, Nelson Bunker Hunt and William Herbert Hunt, respectively, which three notes were acquired by Placid on April 8, 1980.

1.22 "Hunt Collateral" means the collateral securing, among other things, the Hunt Commitment and the Hunt Brothers' Note pursuant to the terms of the Security Documents, which collateral is more particularly described on Exhibit D hereto.

1.23 "Hunt Commitment" has the meaning stated in Section 6.3 hereof.

1.24 "IMIC" means International Metals Investment Company, Ltd., a Bermuda corporation.

1.25 "IMIC Assets" means the assets acquired by the Partnership from IMIC pursuant to Section 9.6 hereof.

1.26 "Initial Position Gain" with respect to a Contributed Asset means the amount, if any, by which the Initial Tax Basis of such asset is less than the Deemed Contribution Value of such asset.

1.27 "Initial Position Loss" with respect to a Contributed Asset means the amount, if any, by which the Initial Tax Basis of such asset exceeds the Deemed Contribution Value of such asset.

1.28 "Initial Tax Basis" with respect to a Contributed Asset means the adjusted tax basis to the Partnership of such asset (for Federal income tax purposes) at the time it is contributed by a Limited Partner to the Partnership.

1.29 "Investment Assets" means the Contributed Assets exclusive of the Coal Properties.

1.30 "Limited Partner Affiliate" means, as to any one or more of the Limited Partners, any person directly or indirectly owned or controlled by, or under common control with, any one or more of the Limited Partners. As used herein, the term "control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a Person, whether through ownership of voting securities, by contract, or otherwise.

1.31 "Limited Partner Entity" means, as to any one or more of the Limited Partners (or any of their descendants), a Person, other than (i) Placid, (ii) a subsidiary of Placid, (iii) the Partnership, (iv) a trust or an employee benefit plan qualified under Section 401 of the Code, or (v) a Limited Partner Affiliate, (a) of which any one or more of the Limited Partners (or any of their descendants) is an officer, director, trustee, or beneficiary, or (b) which is controlled (as defined in "Limited Partner Affiliate") by a Person of which any one or more of the Limited Partners (or any of their descendants) is an officer, director, trustee, or beneficiary.

1.32 "Limited Partner Percentage" in respect of any Limited Partner means the percentage set forth opposite the name of such Limited Partner on Exhibit A hereto.

1.33 "Limited Partners" means the persons or entities who are from time to time admitted to the Partnership as limited partners (including substituted Limited Partners) and whose names, residence addresses, and Limited Partner Percentages are set forth on Exhibit A hereto.

1.34 "Limited Partners' Aggregate Primary Preference" as of any particular date means the aggregate amount of the Limited Partners' Primary Preference computed from the date of the formation of the Partnership through the date in question.

1.35 "Limited Partners' Aggregate Secondary Preference" as of any particular date means the aggregate amount of the Limited Partners' Secondary Preference computed from the date of the formation of the Partnership through the date in question.

1.36 "Limited Partners' Primary Preference" for any period means an amount equal to the product of the Primary Preference Rate (adjusted for the length of the period involved on the basis of a 365 day year) times the lesser of (i) the daily average outstanding balance of the Limited Partners' Unrecovered Investment Contribution during such period or (ii) the daily average unpaid principal balance of the Hunt Brothers' Note during such period.

1.37 "Limited Partners' Secondary Preference" for any period means an amount equal to (i) the product of a rate equal to twenty-five percent (25%) per annum (adjusted for the length of the period involved on the basis of a 365 day year) times (ii) the daily average outstanding balance of the Limited Partners' Unrecovered Investment Contribution during such period.

1.38 "Limited Partners' Unpaid Primary Preference" as of any particular date means the excess of the Limited Partners' Aggregate Primary Preference as of such date over the aggregate amount of cash distributed to the Limited Partners pursuant to Section 8.2.2 hereof.

1.39 "Limited Partners' Unpaid Secondary Preference" as of any particular date means the excess of the Limited Partners' Aggregate Secondary Preference as of such date over the aggregate amount of cash distributed to the Limited Partners pursuant to Sections 8.2.2 and 8.2.6 hereof.

1.40 "Limited Partners' Unrecovered Coal Contribution" means the aggregate amount contributed by the Limited Partners to the capital of the Partnership under Sections 6.1.2 and 6.3.3 reduced by cash distributions from the Partnership pursuant to Section 8.2.8 hereof.

1.41 "Limited Partners' Unrecovered Investment Contribution" means the aggregate amount contributed by the Limited Partners to the capital of the Partnership under Sections 6.1.1, 6.3.1, 6.3.2, and 6.7 and under the last sentence of Section 6.3 reduced by cash distributions from the Partnership pursuant to Section 8.2.7 hereof.

1.42 "Measurement Date" means the last Business Day of each February, May, August, and November.

1.43 "Multi-Bank Loan" means that certain $1,100,000,000 loan evidenced by a "Revolving Credit Agreement" (herein so called) dated as of April 28, 1980, among Placid, as borrower, FNBD and Morgan Guaranty Trust Company of New York, as Co-Agents, and the banks ("Placid's Banks") named therein as lenders, and by other documents specified therein (the Revolving Credit Agreement and other documents collectively, the "Multi-Bank Loan Documents").

1.44 "Multi-Bank Loan Documents" has the meaning stated in Section 1.43 hereof.

1.45 "Net Cash Flow" for any period means (i) the sum of the amount of cash generated by the Partnership from interest, dividends, Coal Properties, or other operations, or by the sale of Partnership assets during such period, plus the amount of cash, if any, contributed during such period to the Partnership by the Limited Partners pursuant to Section 6.3.1 hereof (but excluding cash received in respect of trade equity in an open Qualified Forward and Future Sale Transaction until such time as the contract involved matures or is closed out), less (ii) such amounts as shall be required during such period for application against Partnership Debt or the other obligations of the Partnership, including, without limitation, all operating expenses of the Partnership and expenses provided for in Section 7 hereof, but excluding any amounts required for margin calls or collateral deposits on any Qualified Forward and Future Sale Transaction entered into by the Partnership after the effective date hereof.

1.46 "Option Date" means the date on which (a) each of the following has been reduced to zero: the General Partner's Unpaid Primary Preference; the Limited Partners' Unpaid Primary Preference; the General Partner's Unrecovered Contribution; the General Partner's Unpaid Secondary Preference; and the Limited Partners' Unpaid Secondary Preference; and (b) there has been distributed to the Limited Partners pursuant to Section 8.2.7 hereof amounts sufficient to permit the Limited Partners to pay, in full, the principal on the Hunt Brothers' Note.

1.47 "Partners" means, collectively, the General Partner and the Limited Partners.

1.48 "Partnership" means the limited partnership formed pursuant to this Agreement.

1.49 "Partnership Debt" means the obligations and liabilities to which the Investment Assets are subject, all as more particularly described on Exhibit E hereto.

1.50 "Partnership Return" means the U.S. Partnership Return of Income of the Partnership.

1.51 "Periodic Contribution Amount" on any particular Measurement Date means the excess, if any, of (X) the sum of (i) the General Partner's Unpaid Primary Preference as of such date plus (ii) the Limited Partners' Unpaid Primary Preference as of such date, plus (iii) the Aggregate Pay Down as of such date, over (Y) the sum of (a) the Stated Amount, plus (b) the aggregate amount of cash distributed to the General Partner pursuant to Section 8.2.3 prior to the Measurement Date in question, plus (c) the undistributed Net Cash Flow of the Partnership, if any, on hand on such date (computed without taking into account the capital contribution, if any, to be made by the Limited Partners pursuant to Section 6.3.1 on or with respect to the Measurement Date in question); provided, however, in no event shall the amount of the Aggregate Pay Down (for purposes of this Section 1.51) exceed 98% of the General Partner's Investment. Notwithstanding any provision in this Section 1.51 to the contrary, Net Cash Flow for purposes of this Section 1.51 shall not include the proceeds, if any, from any sale of the Coal Properties during the period in question to the extent such proceeds, pursuant to the provisions of Section 8, are distributable to the Limited Partners under Section 8.2.8 irrespective of the priorities established by Section 8. A worksheet illustrating the principles of the calculation of "Periodic Contribution Amount" is attached hereto as Exhibit G, but in the event of any inconsistencies between such exhibit and this Section, the terms and provisions of this Section shall govern and control.

1.52 "Person" means any individual or any corporation, trust, partnership, firm, association, joint venture or other entity.

1.53 "Placid" means, Placid Oil Company, a Delaware corporation of which the General Partner is a wholly-owned subsidiary.

1.54 "Placid Agent Account" means the special account of Placid at FNBD styled "Placid Oil Company Agent," number 01-2927-0, or any successor account approved by FNBD, which account will be the Partnership's only bank account.

1.55 "Placid Note" means that certain promissory note dated the date of initial funding of the Multi-Bank Loan, with an original principal balance of approximately $272,100,000.00, from the Limited Partners payable to Placid.

1.56 "Placid's Banks" has the meaning stated in Section 1.43.

1.57 "Primary Preference Rate" means a rate equal to eighteen percent (18%) per annum, so long as the amount against which such rate is applied equals or exceeds $25,000; and a rate equal to 10% per annum so long as the amount against which such rate is applied is less than $25,000.

1.58 "Qualified Forward and Future Sale Transaction" shall mean a transaction entered into by the Partnership for the purpose and with the intent of facilitating the orderly disposition of its silver position and which is either a Qualified Forward Sale Transaction or a Qualified Future Sale Transaction. A "Qualified Forward Sale Transaction" shall mean a transaction pursuant to a contract for the forward cash sale of silver by the Partnership with respect to which at the delivery date provided for therein the Partnership will tender, and intends and expects to deliver, silver to the buyer and the buyer agrees to take delivery of silver from the Partnership at the price and in the quantity provided for therein. A "Qualified Future Sale Transaction" shall mean a transaction for the sale of a futures contract for silver with respect to which on or prior to the delivery date provided for therein the Partnership will (i) both sell in the cash market a number of troy ounces of silver equal to the number of troy ounces the sale of which is provided for in the futures contract and immediately close out the related futures contract sold, or (ii) "roll over" the futures contract sold so as to defer the delivery date provided for therein without increasing the quantity of silver sold therein or decreasing the sales price, or (iii) tender delivery of silver against the futures contract sold, provided that this sentence shall in no event be construed to permit any transaction or position which is not a bona fide hedging transaction or position as such terms may be defined from time to time in the Commodity Exchange Act, as amended, and the rules and regulations promulgated thereunder.

1.59 "Representation and Warranty Agreement" means that certain Representation and Warranty Agreement dated May 22, 1980, between the General Partner, the Limited Partners, and Placid.

1.60 "Revolving Credit Agreement" has the meaning stated in Section 1.43.

1.61 "Security Documents" means those certain mortgages and security agreements referenced on Exhibit F hereto.

1.62 "Stated Amount" means: $100,000,000 with respect to any Measurement Date which occurs before the last Business Day of February 1982; $85,000,000 with respect to any Measurement Date which occurs on or after the last Business Day of February 1982, but before the last Business Day of May 1982; $70,000,000 with respect to any Measurement Date which occurs on or after the last Business Day of May 1982, but before the last Business Day of August 1982; $55,000,000 with respect to any Measurement Date which occurs on or after the last Business Day of August 1982, but before the last Business Day of November 1982; $40,000,000 with respect to any Measurement Date which occurs on or after the last Business Day of November 1982, but before the last Business Day of February 1983; $20,000,000 with respect to any Measurement Date which occurs on or after the last Business Day of February 1983, but before the last Business Day of May 1983; and $0 with respect to any Measurement Date which occurs on or after the last Business Day of May 1983.

2. Organization.

2.1 Formation. The parties do hereby create a limited partnership under and pursuant to the Act, and in connection therewith, the parties shall execute a Certificate of Limited Partnership in the form of Exhibit H hereto and shall file such certificate with the Secretary of State of Texas and with appropriate filing officers in such other jurisdictions as the General Partner deems necessary or desirable.

2.2 Name. The name of the Partnership is "Placid Investments, Ltd." The business of the Partnership may be conducted under any name chosen by the General Partner, and the General Partner may in its sole discretion from time to time change the name of the Partnership.

3. Principal Place of Business. The principal place of business of the Partnership shall be located at 1800 First National Bank Building, Dallas, Texas 75202, or at such other place as the General Partner may from time to time determine.

4. Business and Purpose. The principal businesses and purposes of the Partnership shall be (a) the ownership, holding, management, and orderly disposition of the IMIC Assets and the Investment Assets (and in this regard, the General Partner shall utilize the services, and seek the assistance and advice, of qualified independent consultants) and (b) the ownership and holding of the Coal Properties, and, if the General Partner so elects pursuant to Section 8.1.9 hereof, the operation, development, or other exploitation of the Coal Properties.

5. Term. The term of the Partnership shall commence on the date of compliance by the Partners with Section 3 of the Act and shall continue until December 31, 2030, unless terminated sooner because of the dissolution and winding up of the Partnership in accordance with the provisions of Section 12 hereof.

6. Capital Contributions and Status.

6.1 Initial Contributions of Limited Partners.

6.1.1 Contemporaneously with the delivery of this Agreement, the Limited Partners have caused the Investment Assets described on Exhibit B, the balance of the Placid Agent Account, and a note (the "Contribution Note") in the principal amount of $10,000 in the form of Exhibit I hereto, to be transferred, assigned, and conveyed to the Partnership subject to, but without any assumption of, the Partnership Debt. In respect of the contribution of the Investment Assets as described on Exhibit B, the Placid Agent Account, and the Contribution Note, the initial amount of the Limited Partners' Unrecovered Investment Contribution shall be equal to (a) the sum of $10,000, the cash balance of the Placid Agent Account and the Deemed Contribution Values of the Investment Assets described on Exhibit B less (b) the principal balance and unpaid accrued interest on the Partnership Debt. For purposes of this section, the Deemed Contribution Value (i) of silver bullion shall be determined based upon a price of $14.05 per troy ounce, (ii) of silver forward purchase contracts shall be determined based upon a price of $14.05 per troy ounce plus 18% per annum from April 25, 1980, through the settlement date called for in such contracts, (iii) of assets in brokers' margin accounts shall be determined based upon the closing price of such assets on April 25, 1980 on the principal exchange on which each such asset is regularly traded, and (iv) of other assets shall be valued at their closing prices on April 25, 1980, on the principal exchange on which each such asset is regularly traded.

6.1.2 Contemporaneously with the delivery of this Agreement, the Limited Partners have caused the Coal Properties to be transferred, assigned, and conveyed to the Partnership. In respect of the contribution of the Coal Properties, the initial amount of the Limited Partners' Unrecovered Coal Contribution shall be $294,000,000.

6.1.3 The Limited Partners are the owners of certain assets described on Exhibit K hereto which are held in certain brokers' margin accounts subject to certain related margin debt, also described on Exhibit K. Contemporaneously with the delivery of this Agreement, the Limited Partners shall grant Placid or the General Partner exclusive power of attorney over such accounts and the Limited Partners authorize and direct the attorney so appointed to direct each broker with whom such an account is established to proceed to sell, in an orderly fashion, a sufficient quantity of assets within each such account so as to liquidate completely all margin debt (and accrued interest thereon) relating to such account. At such time as the margin debt relating to an account is liquidated, the Limited Partners covenant and agree to forthwith transfer, assign and convey to the Partnership all the remaining assets in such account, whereupon such assets shall become "Investment Assets" as such term is used herein, and the Limited Partners shall have added to the amount of the Limited Partner's Unrecovered Investment Contribution an amount equal to the Deemed Contribution Values of such assets, which Deemed Contribution Values shall be determined based upon the closing prices of such assets on April 25, 1980 on the principal exchange on which each such asset is regularly traded.

6.2 Contribution of General Partner.

6.2.1 Contemporaneously with the initial funding of the Multi-Bank Loan, the General Partner shall contribute to the Partnership the Placid Note, and since the Investment Assets are contributed to the Partnership subject to the Placid Note, the contribution of the Placid Note to the Partnership by the General Partner will have the effect of cancelling the Placid Note. In respect of the contribution of the Placid Note, the initial amount credited to the General Partner's Investment and the General Partner's Unrecovered Contribution shall be the sum of the unpaid principal balance and unpaid accrued interest, if any, on the Placid Note on the date of contribution. In addition, from and after the initial funding of the Multi-Bank Loan, the General Partner agrees to contribute to the Partnership from time to time, as necessary, cash in an amount sufficient to enable the Partnership to discharge the Partnership Debt as it becomes due and to pay the debt incurred or cash disbursements required in connection with the acquisition of certain assets from IMIC described in Section 9.6 below; provided that the aggregate amounts to be contributed pursuant to this sentence shall not exceed $685,000,000.

6.2.2 The General Partner also agrees that, following the Option Date, it shall contribute to the Partnership (a) fifty percent (50%) of the Coal Carry Contribution, and (b) in the event the Partnership elects to develop the Coal Properties pursuant to Section 9.1.9, fifty percent (50%) of the costs of such development.

6.3 Additional Contributions of Limited Partners. The Limited Partners hereby agree to make the following additional contributions to the capital of the Partnership (the "Hunt Commitment"):

6.3.1 On each Measurement Date occurring on or after the last Business Day of February 1981, the Periodic Contribution Amount shall be computed and, at such time, the Limited Partners shall contribute such amount, in cash, to the Partnership.

6.3.2 If, following the liquidation of all of the Investment Assets and the IMIC Assets and the distribution of all of the cash of the Partnership (including the Net Cash Flow resulting from such liquidation) pursuant to Section 8.2 hereof, the General Partner's Unrecovered Contribution has not been reduced to an amount equal to or less than two percent (2%) of the General Partner's Investment, the Limited Partners shall contribute to the capital of the Partnership, within thirty (30) days after written demand therefor by the Partnership, an amount of cash which, when distributed to the Partners pursuant to Section 8.2 hereof, will (i) reduce to zero the General Partner's Unpaid Primary Preference, (ii) reduce to zero the Limited Partner's Unpaid Primary Preference, and (iii) reduce the General Partner's Unrecovered Contribution to an amount equal to two percent (2%) of the General Partner's Investment. The cash contributed to the Partnership by the Limited Partners pursuant to this Section 6.3.2 shall be distributed to the Partners pursuant to Section 8.2 hereof on the date of receipt by the Partnership.

6.3.3 In connection with the contribution of the Coal Properties to the Partnership, the Limited Partners hereby agree to contribute to the Partnership, from time to time upon demand by the General Partner, the Coal Carry Contribution; provided, however, following the Option Date, the Limited Partners shall be required to contribute to the Partnership only fifty percent (50%) of the amount of the Coal Carry Contribution. The Limited Partners hereby agree that, in the event the Partnership elects to develop the Coal Properties pursuant to Section 9.1.9, they will contribute to the Partnership fifty percent (50%) of the costs of such development.

Although it is understood that the Limited Partners have agreed to make the capital contributions required under this Section 6.3 pro rata in accordance with their respective Limited Partner Percentages, the Limited Partners agree that they are obligated, jointly and severally, to make all of the capital contributions required under this Section 6.3. The obligations of the Limited Partners to make the contributions required by the Hunt Commitment and to pay the Contribution Note shall be secured by a second lien on the Hunt Collateral pursuant to the terms and provisions of the Security Documents. Upon the completion of the distribution of Net Cash Flow to the General Partner in an amount sufficient to satisfy the requirements of Sections 8.2.1 and 8.2.3, the Hunt Commitment shall cease and the Hunt Collateral, insofar as it secures the Hunt Commitment, shall be released. In addition to the foregoing, at any time and from time to time, the Limited Partners may voluntarily contribute cash to the Partnership, which contributions shall be distributed to the Partners pursuant to (and in the order of priority provided in) Section 8.2 hereof on the date of receipt by the Partnership.

6.4 Limited Liability. A Limited Partner shall not be bound by, or personally liable for, the expenses, liabilities, or obligations of the Partnership, except as provided in the Act. Except as provided in this Section 6.4 and elsewhere in this Section 6, no Limited Partner shall be required or obligated to make further contributions of any sort whatsoever to the capital of the Partnership; provided, however, that any Limited

Partner receiving a distribution in return, in whole or in part, of his capital contribution shall be liable to the Partnership for any sum, not in excess of such amount returned (with interest), necessary to discharge liabilities of the Partnership to all creditors who extended credit or whose claims arose before such distribution was made.

6.5 Role of Limited Partner. No Limited Partner may take any part in or interfere in any manner with the conduct or control of the business of the Partnership, nor shall any Limited Partner have any right or authority to act for or bind the Partnership.

6.6 Withdrawal of Capital Contributions. No Limited Partner shall have the right to withdraw or reduce his contribution to the capital of the Partnership without the consent of the General Partner. No Limited Partner shall have the right to demand or receive property other than cash in return for his contribution, and no Limited Partner shall have priority over any other Limited Partner, either as to the return of his contribution of capital or as to profits, losses, or distributions.

6.7 Certain Deemed or Additional Required Contributions. The Limited Partners have personally guaranteed the indebtedness of Placid under the Multi-Bank Loan pursuant to that certain Guaranty Agreement (the "Hunt Brothers' Guaranty") dated as of April 28, 1980. In the event that the Limited Partners ever pay any money pursuant to the Hunt Brothers Guaranty, in lieu of any and all rights of subrogation that the Limited Partners, or any of them, might otherwise have against Placid, such amounts (up to the maximum amounts then required to satisfy the distribution requirements of Section 8.2.1 and 8.2.3 hereof) shall be deemed to have been contributed by the Limited Partners to the capital of the Partnership and to have been distributed to the General Partner pursuant to Sections 8.2.1 and 8.2.3 hereof, as applicable, and such deemed contributions and distributions shall be treated as actual contributions and distributions for all purposes of this Agreement. In the event that pursuant to the Hunt Brothers' Guaranty, the Limited Partners are required to purchase the Multi-Bank Loan (the loan so acquired being herein called the "Acquired Note"), then (i) the Limited Partners shall contribute to the capital of the Partnership a portion of the Acquired Note such that the principal and accrued interest on such contributed portion equals the aggregate amount then required to satisfy the distribution requirements of Section 8.2.1 and 8.2.3 hereof, (ii) the Partnership shall forthwith cancel such contributed portion of the Acquired Note, which cancellation shall be deemed to be a distribution to the General Partner pursuant to Sections 8.2.1 and 8.2.3 hereof, which deemed distribution shall be treated as an actual distribution for all purposes of this Agreement, and (iii) the Partnership shall forthwith release all liens and security interests granted by Placid, its subsidiaries, and/or the Partnership to the extent that such liens and/or security interests secure payment of the Acquired Note.

6.8 Information Concerning Initial Tax Basis. Promptly after the execution and delivery of this Agreement, the Limited Partners shall deliver to the General Partner and the Partnership complete information with respect to the Initial Tax Basis of each and all of the Contributed Assets, together with such supporting documentation as may be reasonably requested by the General Partner.

6.9 Concerning the Hunt Collateral.

6.9.1 Pursuant to the Security Documents, the Limited Partners have mortgaged or otherwise granted a security interest in the Hunt Collateral to

best copy available

the Partnership as security for their obligations with respect to the Hunt Commitment. The Partnership agrees, upon the sale, transfer or other disposition of any asset in the Hunt Collateral, which is a Permitted Asset Sale (as that term is defined in the Hunt Brothers' Guaranty), to release its lien upon the asset, provided that (i) concurrently with the release all proceeds required to be paid into the Special Collateral Account by Section 7.3 of the Hunt Brothers' Guaranty are so paid; and (ii) if any Limited Partner should desire to make withdrawals from his Special Collateral Account (established pursuant to Section 7.3(e) of the Hunt Brothers' Guaranty) for any purpose other than to fund the Hunt Commitment, such withdrawal shall require the written consent of the General Partner unless such withdrawal is applied to the obligations of the Limited Partners under the Hunt Brothers' Guaranty.

6.9.2 If the Hunt Brothers' Guaranty should at any time be satisfied and released, but the Hunt Commitment has not been fully satisfied, the Limited Partners and the General Partner agree to enter into a separate agreement respecting the rights of the Limited Partners to make assets sales, and the disposition of the proceeds therefrom, substantially similar to Sections 7.2, 7.3, and 11.9(c) of the Hunt Brothers' Guaranty.

7. Expenses of General Partner.

The General Partner may charge the Partnership (a) for all attorneys' fees and other expenses incurred and/or paid by the General Partner and/or Placid in connection with this Agreement, any agreements entered into pursuant hereto, any transactions related hereto, and any loans and/or loan agreements and transactions pursuant to which the General Partner and/or Placid obtain funds to enable the General Partner to honor its obligations hereunder, and any transactions related to any such loans and/or loan agreements and transactions, (b) for any expenses incurred by the General Partner in connection with the Partnership's business (including fees to investment advisors and consultants) and (c) for an allocable portion of expenses incurred by the General Partner in connection with both Partnership and other activities, such allocation to be determined on any basis selected by the General Partner consistent with good accounting practices.

8. Allocations of Income, Gain, and Loss; Distributions of Cash.

8.1 Allocations of Income, Gain, and Loss. For federal income tax purposes for each calendar year, the income, gain, and loss of the Partnership (exclusive of income from and deductions for guaranteed payments pursuant to Section 8.3 hereof) shall be allocated as follows:

8.1.1 With respect to a sale of a Contributed Asset, the amount of the Initial Position Gain or Initial Position Loss, if any, with respect to such asset shall be allocated to the Limited Partner(s) who contributed such asset to the Partnership. Additional gain or loss resulting from the sale of any such asset, if any, shall be allocated to the Partners as provided in Sections 8.1.2, 8.1.3, and 8.1.4 below.

8.1.2 For each year, if after taking into account gains and losses from the sale of Partnership assets during such year, (a) the Aggregate Allocation

Amount of a Limited Partner is positive, the gain, if any, from the sale of Partnership assets during the year, to the extent not allocated pursuant to Section 8.1.1 above, up to an amount equal to the Aggregate Allocation Amount of such Limited Partner, shall be allocated to such Limited Partner; or (b) the Aggregate Allocation Amount of a Limited Partner is negative, the losses, if any, from the sale of Partnership assets during the year, to the extent not allocated pursuant to Section 8.1.1 above, up to an amount equal to the Aggregate Allocation Amount of such Limited Partner, shall be allocated to such Limited Partner. If gain or loss is to be allocated to more than one Limited Partner and if the sum of the positive (or negative, as the case may be) balances of their Aggregate Allocation Amounts exceeds the amount of gain (or loss, as the case may be) available for allocation, then the amount of gain (or loss, as the case may be) available for allocation shall be allocated to the appropriate Limited Partners, pro rata in accordance with the relative magnitude of the positive (or negative, as the case may be) balances of their respective Aggregate Allocation Amounts. Additional gain or loss resulting from the sale of any such assets, if any, together with all other income, gain, or loss shall be allocated to the Partners as provided in Sections 8.1.3 and 8.1.4 below.

8.1.3 All other income or gain of the Partnership shall be allocated to the Partners in the following order of priority:

8.1.3.1 First, an amount of gain up to the sum of the Primary Preference Allocation Amounts of the General Partner and Limited Partners, shall be allocated to the General Partner and Limited Partners pro rata in accordance with the relative amounts of their respective Primary Preference Allocation Amounts. The Primary Preference Allocation Amount of the General Partner shall be equal to (a) the aggregate amount of cash distributed (in the current and all prior years) to the General Partner pursuant to Section 8.2.1 hereof, less (b) the aggregate amount of income previously allocated to the General Partner pursuant to this Section 8.1.3.1 and less (c) the aggregate amount of income allocated (in the current and all prior years) to the General Partner pursuant to clause (b) of Section 8.3 hereof. The Primary Preference Allocation Amount of the Limited Partner shall be equal to (i) the aggregate amount of cash distributed (in the current and all prior years) to the Limited Partner pursuant to Section 8.2.2 hereof less (b) the aggregate amount of income previously allocated to the Limited Partners pursuant to this Section 8.1.3.1.

8.1.3.2 Next, an amount of gain up to the sum of the Secondary Preference Allocation Amounts of the General Partner and Limited Partners, shall be allocated to the General Partner and Limited Partners pro rata in accordance with the relative amounts of their respective Secondary Preference Allocation Amounts. The Secondary Preference Allocation Amount of the General Partner shall be equal to (a) the aggregate amount of cash distributed (in the current and all prior years) to the General Partner pursuant to Section 8.2.5 hereof less (b) the aggregate amount of income previously allocated to the General Partner pursuant to this Section 8.1.3.2. The Secondary Preference Allocation Amount of the Limited Partner shall be equal to (i) the aggregate amount of cash distributed (in the current and all prior years) to the Limited Partner pursuant to Section 8.2.6 hereof less (b) the aggregate amount of income previously allocated to the Limited Partners pursuant to this Section 8.1.3.2.

8.1.3.3 Next, to the General Partner until the aggregate amount of income allocated to the General Partner pursuant to this Section 8.1.3.3 is equal to the aggregate amount of losses, if any, previously allocated to the General Partner pursuant to Section 8.1.4.

8.1.3.4 Next, to the Limited Partners until the aggregate amount of income allocated to the Limited Partners pursuant to this Section 8.1.3.4 is equal to the aggregate amount of losses, if any, previously allocated to the Limited Partners pursuant to Sections 8.1.4 and 8.3.

8.1.3.5 All additional income, if any, shall be allocated fifty percent (50%) to the General Partner and fifty percent (50%) to the Limited Partners in accordance with their respective Limited Partner Percentages.

8.1.4 All other losses of the Partnership shall be allocated to the Partners in the following order of priority:

8.1.4.1 First, to the Limited Partners, until the aggregate amount of losses allocated under this Section 8.1.4.1 is equal to (a) the aggregate amount, if any, of contributions made by the Limited Partners to the capital of the Partnership pursuant to Section 6.3 above reduced by (b) the aggregate amount of losses allocated to the Limited Partners in respect of guaranteed payments pursuant to clause (c) of Section 8.3 below.

8.1.4.2 All remaining losses, if any, shall be allocated to the General Partner.

8.1.5 All allocations to the Limited Partners pursuant to Sections 8.1.3 and 8.1.4 shall be pro rata in accordance with their respective Limited Partner Percentages.

8.2 Distributions of Net Cash Flow. From time to time, the Net Cash Flow, if any, of the Partnership in excess of a reasonable working capital reserve not to exceed $25,000,000, shall be distributed to the Partners in the following order of priority (distributions to the Limited Partners to be in accordance with their respective Limited Partner Percentages):

8.2.1 First, to the General Partner, until the General Partner's Unpaid Primary Preference is reduced to zero. A portion of the distributions pursuant to this Section 8.2.1 may be guaranteed payments, as more particularly provided in Section 8.3 hereof.

8.2.2 Second, to the Limited Partners, until the Limited Partners' Unpaid Primary Preference is reduced to zero.

8.2.3 Third, to the General Partner, as a return of capital, until the General Partner's Unrecovered Contribution is equal to two percent (2%) of the General Partner's Investment.

8.2.4 Fourth, to the General Partner, as a return of capital, until the General Partner's Unrecovered Contribution is reduced to zero.

8.2.5 Fifth, to the General Partner, until the General Partner's Unpaid Secondary Preference is fully paid.

8.2.6 Sixth, to the Limited Partners, until the Limited Partners' Unpaid Secondary Preference is reduced to zero.

8.2.7 Seventh, to the Limited Partners, as a return of capital, until the Limited Partners' Unrecovered Investment Contribution is reduced to zero.

8.2.8 Eighth, to the Limited Partners, as a return of capital, until the Limited Partners' Unrecovered Coal Contribution is reduced to zero; provided, however, that the aggregate amount of cash that may be distributed to the Limited Partners under this Section 8.2.8 may in no event exceed the aggregate amount of net cash proceeds previously realized by the Partnership from or in respect of operations or sales of the Coal Properties.

8.2.9 Ninth, the remaining Net Cash Flow, if any, shall be distributed fifty percent (50%) to the General Partner and fifty percent (50%) to the Limited Partners.

All Net Cash Flow in excess of the working capital reserve permitted by the first sentence of this Section 8.2 shall be distributed by the Partnership promptly whenever the Partnership has on hand Net Cash Flow which exceeds the amount of such reserve by more than $5,000,000.

Notwithstanding any provision in this Section 8.2 to the contrary, there shall be distributed to the Limited Partners pursuant to Section 8.2.8 hereof an amount equal to the lesser of (i) $100,000,000 of the net proceeds from any sale of the Coal Properties, (ii) one-third of the net proceeds from any sale of the Coal Properties, or (iii) an amount equal to the income taxes payable by the Limited Partners that would not have been incurred by them but for the sale of the Coal Properties. Prior to receiving any distribution pursuant to the preceding sentence, the Limited Partners shall furnish to the General Partner such evidence and information as the General Partner may reasonably require relating to the amount of income taxes payable by the Limited Partners that would not have been incurred but for such sale, and such distribution shall be made to the Limited Partners only at the times that payments of such taxes are required.

If the General Partner pursuant to Section 9.1.10 causes the Partnership to distribute the Coal Properties to the Limited Partners, such distribution shall be treated as a distribution pursuant to Section 8.2.8 hereof; in the event of such a distribution, the Limited Partners' Unrecovered Coal Contribution shall be reduced by $294,000,000.

In the event of a sale of less than all of the Coal Properties or a distribution of less than all of the Coal Properties to the Limited Partners pursuant to Section 9.1.10, then in lieu of the amounts of $100,000,000 and $294,000,000 utilized in the two immediately preceding paragraphs, there shall be substituted an amount equal to $100,000,000 or $294,000,000, as the case may be, multiplied by a fraction, the numerator of which shall be the Deemed Contribution Value of that portion of the Coal Properties sold or distributed and the denominator of which shall be $294,000,000.

8.3 Certain Guaranteed Payments. If during a calendar year the Limited Partners make contributions to the capital of the Partnership pursuant to Sections 6.3.1, 6.3.2 or 6.7 hereof and during such year distributions are made to the General Partner pursuant to Section 8.2.1 hereof, then for such year (a) a portion of such distribution under Section 8.2.1 equal to the "Defined Amount" (hereinafter defined) shall be a guaranteed payment to the General Partner within the meaning of Section 707(c) of the Code, (b) such amount shall be reported by the General Partner as ordinary income under Section 61(a) of the Code, and (c) such amount shall be deducted by the Partnership under Section 162(a) of the Code, which deduction shall be specially allocated to the Limited Partners pro rata in accordance with their respective Limited Partner Percentages. As used herein, "Defined Amount" with respect to any year shall mean an amount equal to the lesser of (i) the aggregate contributions made during such year by the Limited Partners pursuant to Sections 6.3.1, 6.3.2 and 6.7 hereof, net of any distributions to the Limited Partners during such year pursuant to Sections 8.2.2, 8.2.6, and 8.2.7 hereof, (ii) the aggregate amount distributed to the General Partner during such year pursuant to Section 8.2.1 hereof, or (iii) the amount of interest accrued during such year on the Multi-Bank Loan, less the amount of interest accrued during such year on the Hunt Brothers' Note.

9. Rights, Powers, and Obligations of General Partner.

9.1 Powers. Subject to the provisions of Section 9.4 hereof, the management and control of the Partnership and its business and affairs shall rest exclusively with the General Partner, who shall have all the rights and powers which may be possessed by a general partner pursuant to the Act, and such rights and powers as are otherwise conferred by law, or are necessary, advisable, or convenient to the discharge of its duties under this Agreement and to the management of the business and affairs of the Partnership. Without limiting the generality of the foregoing, the General Partner shall have the following rights and powers, which it may exercise at the cost, expense, and risk of the Partnership:

9.1.1 To spend the capital and net income of the Partnership in the exercise of any rights or powers possessed by the General Partner hereunder;

9.1.2 To sell, dispose of, trade, exchange, convey, quitclaim, surrender, release, or abandon, at such price or prices and upon such other terms and conditions as the General Partner in its sole discretion may deem advisable, appropriate, or convenient, the assets of the Partnership;

9.1.3 To encumber the Contributed Assets and the IMIC Assets as security for repayment of borrowings permitted pursuant to Section 9.1.5 hereof; to execute and deliver any notes, security agreements, loan agreements, or any other documents whatsoever in connection with such transactions, which documents may contain such terms, provisions, and conditions as the General Partner in its sole and absolute discretion shall approve; provided, however, that prior to the time that Placid has repaid the Multi-Bank Loan in full, transactions described in this Section 9.1.3 may be entered into only to secure debt referred to in the last proviso of Section 9.1.5 hereof or to secure the obligations of the Partnership under any Qualified Forward Sale Contract;

9.1.4 To purchase from or through others contracts of liability, casualty, and other insurance which the General Partner deems advisable, appropriate, or convenient for the protection of the assets and affairs of the Partnership or for any purpose convenient or beneficial to the Partnership;

9.1.5 To borrow money upon such terms and conditions as the General Partner in its sole and absolute discretion shall approve from the General Partner or others to discharge the Partnership's obligations (including, without limitation, the Partnership Debt) or to protect and preserve the assets of the Partnership, or to refinance any loans or other indebtedness of the Partnership, or to incur any other indebtedness in the ordinary course of business of the Partnership; provided, however, any funds advanced by the General Partner to the Partnership pursuant to Section 9.5 hereof shall bear interest at the highest lawful rate per annum from the date advanced until repaid, and such loans and all interest on such loans shall be repaid to the General Partner as an operating expense of the Partnership for purposes of computing Net Cash Flow; provided, however, that prior to the time that Placid has repaid the Multi-Bank Loan in full, debt permitted by this Section 9.1.5 may be incurred solely for the purpose of financing margin requirements in connection with Qualified Future Sale Transactions;

9.1.6 To execute and deliver any notes, security agreements, loan agreements, or any other documents whatsoever to evidence or secure the repayment of any borrowing or indebtedness permitted by Section 9.1.5 hereof, which documents may contain such terms, provisions, and conditions as the General Partner in its sole and absolute discretion shall approve;

9.1.7 To delegate all or any of its duties hereunder and, in furtherance of any such delegation, to appoint, employ, or contract with any persons (other than a Limited Partner) it may in its sole discretion deem necessary or desirable for the transaction of the business of the Partnership, which persons may, under the supervision of the General Partner, administer the day-to-day operations of the Partnership; may serve as the Partnership's advisors and consultants in connection with policy decisions made by the General Partner; may act as consultants, accountants, correspondents, attorneys, brokers, escrow agents, or in any other capacity deemed by the General Partner necessary or desirable; may investigate, select, and, on behalf of the Partnership, conduct relations with persons acting in such capacities and may pay appropriate reasonable fees to, and enter into appropriate contracts with, or employ, or retain services performed or to be performed by, any of them in connection with the business of the Partnership; may perform or assist in the performance of such administrative or managerial functions necessary in the management of the Partnership as may be agreed upon with the General Partner; and may perform such other acts or services for the Partnership as the General Partner in its sole and absolute discretion may approve;

9.1.8 To pay any and all fees and expenses incurred in the organization of the Partnership, the acquisition of the Contributed Assets, and the operation and business and affairs of the Partnership, in such order of priority as the General Partner may in its sole and absolute discretion deem advisable, appropriate, or convenient;

9.1.9 At any time following the Option Date and in the sole discretion of the General Partner, to cause the Coal Properties to be developed, mined, and otherwise exploited by the Partnership; and

9.1.10 At any time following the Option Date and in the sole discretion of the General Partner, to cause the Coal Properties, if then owned by the Partnership, to be distributed by the Partnership to the Limited Partners; provided, however, that following such distribution neither the General Partner nor the Partnership shall have any interest in or obligation with respect to the Coal Properties.

9.2 Independent Activities. During the term of the Partnership, the General Partner shall have no activities other than serving as such hereunder. Subject to the covenants of the Limited Partners in Section 16 hereof, each Limited Partner may, notwithstanding the existence of this Agreement, engage in whatever activities he chooses, whether the same be competitive with the Partnership or otherwise, without having or incurring any obligation to offer any interest in such activities to the Partnership or any party hereto.

9.3 Duties. The General Partner shall manage and control the Partnership, its business, and its affairs to the best of the ability of the General Partner and shall use its best efforts to carry out the businesses and purposes of the Partnership. The General Partner shall devote itself to the business of the Partnership to the extent that it, in its sole and absolute discretion, determines is necessary for the efficient carrying on thereof. Whenever reasonably requested by the Limited Partners, the General Partner shall render a just and faithful account of all dealings and transactions relating to the business of the Partnership.

9.4 Certain Limitations.

9.4.1 Without obtaining the consent of all of the Limited Partners, the General Partner shall not do any of the following:

9.4.1.1 Act in contravention of this Agreement;

9.4.1.2 Do any act which would make it impossible to carry on the ordinary business of the Partnership;

9.4.1.3 Confess a judgment against the Partnership;

9.4.1.4 Admit a person as a General Partner or as a Limited Partner, except as otherwise provided in Section 10 of this Agreement;

9.4.1.5 Execute or deliver any assignment of all or substantially all of the Partnership's assets for the benefit of the creditors of the Partnership;

9.4.1.6 Possess Partnership property, or sell, transfer, assign, pledge, or subject to mortgage or security interest any Partnership property for other than a Partnership purpose; or

9.4.1.7 Borrow any money from the Partnership.

9.4.2 Without obtaining the consent of Limited Partners having an aggregate Limited Partner Percentage of more than fifty percent (50%), the General Partner shall not do any of the following:

9.4.2.1 Borrow any money on behalf of the Partnership, except as otherwise permitted in this Agreement, or incur any other indebtedness, except in the ordinary course of the business of the Partnership; or

9.4.2.2 Amend this Agreement, except as provided in Section 18.4 hereof.

9.4.3 The General Partner will not permit the Partnership (i) to take any new commodities position which results in a net increase in such positions, nor (ii) to take any new commodities position for any speculative purpose. It is agreed and understood that the entering into by the Partnership of Qualified Forward and Future Sale Transactions will not be construed as involving a net increase in the Partnership's silver position or be construed as being for a speculative purpose so long as the aggregate number of troy ounces of silver at any time covered by all Qualified Forward and Future Sale Transactions to which the Partnership is a party does not exceed the aggregate number of troy ounces of silver then owned by the Partnership (including silver which the Partnership is then obligated to acquire). It is further understood and agreed that the rolling forward of existing forward purchase contracts will not be construed to involve a net increase in the Partnership's silver position or be construed as being for a speculative purpose.

9.5 Agreements of General Partner and Limited Partners. In the event that at any time during the term hereof the cash funds of the Partnership on hand at such time are not sufficient for (i) payment of all expenses of the Partnership as of such time and (ii) provision for payment of all outstanding and unpaid current obligations of the Partnership as of such time, the General Partner may in its sole and absolute discretion advance to the Partnership all or any portion of such funds as may be necessary to cover such deficit; provided, however, the General Partner shall have no obligation to the Partnership or the Limited Partners to advance any such funds to the Partnership. Any such funds so advanced by the General Partner to the Partnership shall bear interest at the highest lawful rate per annum from the date advanced until repaid. Nothing in this Section 9.5 shall diminish the General Partner's obligation to make capital contributions to the Partnership pursuant to Section 6.2.

9.6 Acquisition of Certain IMIC Assets. Concurrently with or as soon as practicable after the initial funding of the Multi-Bank Loan, the General Partner shall consummate a transaction (a) pursuant to which the Partnership shall purchase for cash from IMIC, at a price equal to $14.05 per troy ounce, an amount of silver collateral (excluding silver futures and related net open trade equity) securing IMIC's debt to Merrill Lynch Pierce Fenner & Smith, Inc. equal in value to such debt (except the portion of such debt secured by Treasury bills and silver futures and any related net open trade equity),

(b) pursuant to which the Partnership shall have obtained the right to any refund of margin held by Merrill Lynch Pierce Fenner & Smith, Inc. in connection with certain IMIC silver futures contracts, the funds for which margin were provided by obligations of one or more of the Limited Partners that are included within Partnership Debt, and (c) pursuant to which the Limited Partners shall have obtained a release of their obligations under a certain pledge agreement (dated April 1, 1980) with Merrill Lynch Pierce Fenner & Smith, Inc. and shall have obtained a release of any collateral (which released collateral shall be part of the Contributed Assets) pledged under such agreement. Solely in order to permit implementation of the transactions contemplated by this Section 9.6 and notwithstanding Section 16(d) hereof, William Herbert Hunt may pledge up to $20,000,000 worth of assets to secure certain obligations of IMIC.

9.7 Mortgage of Coal Properties. The General Partner is authorized to cause the Partnership to mortgage (or otherwise grant a security interest in) the Coal Properties in favor of Placid's Banks as security for the obligations of Placid and the General Partner for their obligations under or guarantys of the Multi-Bank Loan.

10. Transfers of Interests in Partnership.

10.1 General Partner. Subject to the limitations imposed by the Multi-Bank Loan Documents, the General Partner may sell, assign, encumber, or otherwise dispose of all or any part of its interest in the Partnership, and its assignee shall have the right to become general partner of the Partnership. In particular, but without limitation, the General Partner may pledge and assign its interest in the Partnership (and the Hunt Collateral) as security for the Multi-Bank Loan and the General Partner's guaranty of such loan, and the Limited Partners hereby accept and acknowledge such pledge and assignment and agree to take promptly upon the request of Placid's Banks or their agents all steps necessary to allow Placid's Banks the full and unrestricted exercise of their rights and remedies with respect to such pledge and assignment. No such sale, transfer, or assignment of a portion of the General Partner's interest in the Partnership shall affect (i) the Limited Partner Percentages, or (ii) the interest of the Limited Partners in the capital and profits of the Partnership, including their right to an allocation of the net income or net loss of the Partnership at the time and in the manner and amounts specified in Sections 8.1 and 8.3 hereof or their right to receive a distribution of the Net Cash Flow of the Partnership at the time and in the manner and amounts specified in Section 8.2 hereof.

10.2 Limited Partners. Except as permitted by this Section 10, a Limited Partner may not sell, transfer, assign, or subject to a security interest all or any part of his interest in the Partnership, and any act in violation of this Section 10 shall be null and void ab initio. A Limited Partner shall not sell, transfer, assign, or subject to a security interest any or all of his interest in the Partnership without the written consent of the General Partner and Placid's Banks, which consent may be given or withheld in the sole discretion of the General Partner and any such banks; and, provided further, however, that any such purchaser, transferee, assignee, or holder of such security interest (or any person who purchases such interest upon foreclosure of such security interest) shall not become a substituted Limited Partner within the meaning of the Act unless the General Partner consents in writing to such person becoming a substituted Limited Partner, which consent may be given or withheld in the sole and absolute discretion of the General Partner. Under no circumstances, for a period of nine (9) months from the date of the commencement of the term of the Partnership, may a Limited Partner sell, transfer, assign, or otherwise dispose of all or any part of his interest in the Partnership to other than a bona fide resident of the State of Texas. The Limited Partners are hereby authorized, and it is understood that they shall, contemporaneously herewith, grant to Placid a first lien security interest in their interests in the Partnership as collateral security for their payment of the Hunt Brothers' Note and grant to Placid's Banks a second lien security interest in their interests in the Partnership as collateral security for their obligations under the Hunt Brothers' Guaranty.

10.3 Substituted Limited Partners. If the General Partner consents to the admission of a person as a substituted Limited Partner within the meaning of the Act, and such person:

10.3.1 Elects to become a substituted Limited Partner by delivering a written notice of such election to the General Partner;

10.3.2 Executes and acknowledges such other instruments as the General Partner may deem necessary or advisable to effect the admission of such person as a substituted Limited Partner, including, without limitation, the written acceptance and adoption by such person of the provisions of this Agreement; and

10.3.3 Pays a transfer fee to the Partnership which is sufficient to cover all reasonable expenses connected with the admission of such person as a substituted Limited Partner within the meaning of the Act, including, without limitation, the cost of preparing and filing for record an amendment to this Agreement in accordance with the Act;

this Agreement shall be amended in accordance with the provisions of the Act; all other steps shall be taken which, in the opinion of the General Partner, are reasonably necessary to admit such person under the Act as a substituted Limited Partner; and such person shall thereupon become a substituted Limited Partner within the meaning of the Act.

11. Resignation or Removal of General Partner.

11.1 Resignation of General Partner. The General Partner may not resign from the Partnership except upon a transfer of all of its interest in the Partnership pursuant to Section 10.1 hereof.

11.2 Removal of General Partner. No Partner or group of Partners shall have the right to remove the General Partner.

12. Dissolution and Winding Up of the Partnership.

12.1 Dissolution of the Partnership. The Partnership shall be dissolved upon the first to occur of any of the following events:

12.1.1 The death of the General Partner, or, if the General Partner is other than a natural person, upon its dissolution or liquidation;

12.1.2 The adjudication that the General Partner is mentally incompetent, insolvent, or bankrupt (as used herein, the term "bankrupt" shall be considered to include not only formal adjudication that the General Partner is bankrupt, but also that the General Partner has made an assignment for the benefit of creditors or that there has been appointed a receiver for its property or affairs and such receiver is not removed within thirty (30) days after appointment);

12.1.3 The expiration of the term of the Partnership;

12.1.4 The sale of all the Contributed Assets and the IMIC Assets, unless promissory notes, payable to the order of the Partnership, are received by the Partnership as a portion of the consideration for the sale of such assets; or

12.1.5 The payment in full of the promissory notes referred to in Section 12.1.4 hereof.

The death, bankruptcy, or adjudication of incompetency of a Limited Partner shall not cause a dissolution or termination of the Partnership.

12.2 Winding Up of the Partnership. Upon a dissolution of the Partnership pursuant to Section 12.1 hereof, the General Partner (or, if there is no General Partner, Placid acting as a trustee in liquidation) shall take full account of the Partnership's assets and liabilities, the assets shall be liquidated as promptly as is consistent with obtaining the fair value thereof, and the proceeds therefrom, to the extent sufficient therefor, shall be applied and distributed in the following order:

12.2.1 To the payment and discharge of all of the Partnership's debts and liabilities to persons other than Partners or former Partners and the expenses of liquidation;

12.2.2 To the payment and discharge of all of the Partnership's debts and liabilities to Partners or former Partners; and

12.2.3 The balance, if any, shall be distributed to the Partners in accordance with the provisions of Section 8.2 hereof.

13. Books of Account, Accounting, Reports, Fiscal Year, Banking, Tax Election, and Certain Records.

13.1 Books of Account. The Partnership's books and records and this Agreement shall be maintained at the principal office of the Partnership and each Partner shall have access thereto at all reasonable times. The books and records shall be kept on the accrual method of accounting applied in a consistent manner by the Partnership and shall reflect all Partnership transactions and be appropriate and adequate for the Partnership's business.

13.2 Accounting and Reports. As soon as reasonably practicable after the end of each fiscal year, but not later than one hundred twenty (120) days after the end of each such year, each Partner shall be furnished with a copy of a balance sheet of the Partnership as of the last day of such fiscal year and a statement of income or loss of the Partnership for such year, and a statement showing the amounts allocated to or allocated against such Partner pursuant to this Agreement during or in respect of such year, and any items of income, deduction, credit, or loss allocated to him for purposes of the Code, and any applicable state or local income tax laws pursuant to this Agreement. Such balance sheet and statements of income shall be prepared by an independent Certified Public Accountant on the accrual method of accounting.

13.3 Fiscal Year. The fiscal year of the Partnership shall be the calendar year.

13.4 Bank Account. All capital contributions by the General Partner, all proceeds of sale of Partnership assets, all payments received in respect of Investment Assets and IMIC Assets, all income, dividends, and other revenues received from or in respect of Partnership assets and all amounts contributed in respect of the Hunt Commitment shall be deposited in the Placid Agent Account. Prior to any disbursement from such account for any purpose other than (a) a distribution to the General Partner pursuant to Section 8.2 hereof which is simultaneously paid by the General Partner through Placid to Placid's Banks, or (b) a distribution to the Limited Partners in respect of the Limited Partners' Unrecovered Investment Contribution or the Limited Partners' Unpaid Primary Preference which is simultaneously paid by them to Placid in respect of the Hunt Brothers' Note and by Placid to Placid's Banks pursuant to the Multi-Bank Loan Documents, an authorized representative of the General Partner must deliver a written statement to an authorized representative of FNBD that the proposed use of funds will not violate the intent or provisions of this Agreement or the Multi-Bank Loan Documents.

13.5 Tax Election. Upon the transfer of an interest in the Partnership or in the event of a distribution of the Partnership's property, the Partnership shall elect pursuant to Section 754 of the Code to adjust the basis of the Partnership's property as allowed by Sections 734(b) and 743(b) thereof.

13.6 Partnership Returns. The General Partner shall, for each fiscal year, file on behalf of the Partnership a Partnership Return (utilizing the accrual method of accounting) within the time prescribed by law (including extensions) for such filing. The General Partner shall also file on behalf of the Partnership such state and/or city income tax returns as may be required by law.

13.7 Certain Records of the Limited Partners and the Partnership. The Limited Partners agree that the General Partner may make available to banks which lend money to Placid or the General Partner any records, reports, or documents concerning the Limited Partners' and the Partnership's financial conditions which the banks may wish to review from time to time, including, without limitation, those financial statements provided to the General Partner pursuant to Section 16 hereof.

14. Power of Attorney.

14.1 Each Limited Partner hereby makes, constitutes, and appoints the General Partner, and any successor General Partner, with full power of substitution and resubstitution, its true and lawful attorney for him and in his name, place, and stead and for his use and benefit, to sign, execute, certify, acknowledge, swear to, file, and record this Agreement and all certificates of limited partnership, fictitious or assumed name certificates, and other certificates and instruments which the General Partner deems necessary or appropriate to qualify or to continue the Partnership as a limited partnership or to conduct the business of the Partnership, and to sign, execute, certify, acknowledge, file, and record all instruments amending this Agreement or any such certificates or instruments, as now or hereafter amended, that may be appropriate, including, without limitation, agreements or other instruments or documents (i) to reflect the exercise by the General Partner of any of the powers granted to it under this Agreement; (ii) to reflect any amendments made to this Agreement by the Partners pursuant to this Agreement; (iii) to reflect the admission to the Partnership of any substituted Limited Partner or the withdrawal of any Partner in the manner prescribed in this Agreement; and (iv) which may be required of the Partnership or of the Partners by the laws of the State of Texas or any other jurisdiction. Each Limited Partner authorizes each such attorney-in-fact to take any further action which such attorney-in-fact shall consider necessary or advisable in connection with any of the foregoing, hereby giving such attorney-in-fact full power and authority to do and perform each and every act or thing whatsoever requisite or advisable to be done in and about the foregoing as fully as such Limited Partner might or could do if personally present, and hereby ratifying and confirming all that each such attorney-in-fact shall lawfully do or cause to be done by virtue hereof.

14.2 The power of attorney granted pursuant to Section 14.1 hereof:

14.2.1 Is a special power of attorney coupled with an interest and is irrevocable;

14.2.2 May be exercised by each such attorney-in-fact by listing all of the Limited Partners executing any agreement, certificate, instrument, or document with the single signature of such attorney-in-fact acting as attorney-in-fact for all of them; and

14.2.3 Shall survive the delivery of an assignment by a Limited Partner of the whole or a portion of his Interest in the Partnership, except that where the purchaser, transferee, or assignee thereof has the right to be, or with the consent of the General Partner, is admitted as a substituted Limited Partner, the power of attorney shall survive the delivery of such assignment for the sole purpose of enabling each such attorney-in-fact to execute, acknowledge, swear to, and file any such agreement, certificate, instrument, or document necessary to effect such substitution.

15. Liability and Indemnification of General Partner.

15.1 Exoneration. Except in case of gross negligence or willful misconduct, the doing of any act or the failure to do any act by the General Partner, the effect of which may cause or result in loss or damage to the Partnership, shall not subject the General Partner to any liability to the Limited Partners or the Partnership.

15.2 Indemnification. The Partnership shall indemnify and hold harmless the General Partner, Placid, and each of their and the Partnership's respective employees or agents against any and all claims, actions, demands, costs, expenses (including attorneys' fees), damages, loss, and threat of loss, as a result of any claim or legal proceeding relating to the performance or non-performance of any act concerning the activities of the Partnership; provided, however, the party against whom the claim is made, or legal proceeding is directed, shall not have been guilty of gross negligence or willful misconduct.

In addition, the Limited Partners, jointly and severally, agree to indemnify the Partnership, the General Partner and Placid and hold them harmless from and against any and all liabilities, losses, damages, penalties, actions, judgments, suits, claims, costs, expenses, and disbursements of any kind or nature whatsoever which may be imposed on, incurred by, or asserted against the Partnership, the General Partner or Placid (i) in any way relating to or arising out of any previous or future transactions or dealings relating to the Investment Assets, (ii) in any way relating to or arising out of a breach of a representation or warranty of the Limited Partners, or any of them, contained in the Representation and Warranty Agreement or (iii) in any way relating to or arising out of this Agreement or the Multi-Bank Loan or any of the transactions contemplated herein or therein; provided, however, the Limited Partners shall not have any obligation to indemnify the Partnership, the General Partner or Placid under this Section 15.2 with respect to (a) liabilities, damages, or other expenses imposed on, incurred by, or asserted against the Partnership, the General Partner or Placid because of the Partnership's, the General Partner's or Placid's, as appropriate, gross negligence or willful misconduct, or (b) economic loss incurred by the General Partner or Placid incurred by virtue of the contributions made by the General Partner herein (except to the extent that such loss is covered by the obligations of the Limited Partners with respect to the Hunt Commitment). The Limited Partners agree to pay to the indemnified party or parties all amounts due under this paragraph on demand from time to time, together with (x) interest at the highest lawful rate from the date of demand until the date of payment and (y) attorneys' fees and court costs incurred by the indemnified party or parties in the enforcement of the indemnification contained in this paragraph and the collection of the amounts due hereunder.

15.3 No Personal Liability. Anything in this Agreement to the contrary notwithstanding, the General Partner shall not be personally liable for the return of the capital contributions of the Limited Partners, or any portion thereof, it being expressly understood that any such return shall be made solely from Partnership assets.

16. Certain Covenants by the Limited Partners. The Limited Partners covenant and agree during the term of the Partnership that no Limited Partner will, and no Limited Partner will permit any Limited Partner Affiliate to, and each Limited Partner will use its best efforts not to permit any Limited Partner Entity to:

(a) Make any new investments in securities, other than investments in short term United States government obligations, certificates of deposit of and time deposits in commercial banks with capital, surplus, and undivided profits exceeding $300,000,000, and short-term commercial paper rated in the highest category by a nationally recognized rating agency; or

(b) Make investments or take any new positions in any commodity (including without limitation silver or any other precious metal) or any commodity or other future, forward or option contract, for any speculative purpose or otherwise other than investments in commodities necessary for the prudent operation in the ordinary course of business of the farm and ranching businesses of the Limited Partners described in Exhibit "F" to the Hunt Brothers' Guaranty and the sugar businesses owned and operated by Limited Partner Affiliates or Limited Partner Entities; or

(c) Enter into, or permit any other person for whose obligations they (or any of them) may be liable to enter into, any commitment or guaranty or incur any other obligation which could require the payment of material sums of money, except in the ordinary, prudent course of operating the businesses described in Exhibit "F" to the Hunt Brothers' Guaranty; or

(d) Guaranty or pledge any assets to secure any obligations of IMIC.

It is understood and agreed that the rolling forward of existing gold and silver futures positions of Penrod Drilling Company, Placid, and Hunt Energy Corporation for hedging purposes in connection with awards heretofore made by those companies, respectively, under certain of their respective employee benefit plans, will not be construed to involve a net increase in or a new commodities positions or be for a speculative purpose.

Without limiting the generality of the foregoing, each of William Herbert Hunt and Nelson Bunker Hunt will take all steps consistent with applicable law in order that IMIC will (i) manage and dispose of in an orderly manner its silver position, (ii) take no new commodities position which results in a net increase in such positions and (iii) take no new commodities position for any speculative purpose; provided, however, that the obligations of William Herbert Hunt and Nelson Bunker Hunt under this sentence shall not require them to undertake any obligation inconsistent with their covenants under Sections 16(c) and 16(d) hereof.

Further, during the term of the Partnership, the Limited Partners agree to review at least monthly with the Board of Directors of the General Partner and Placid the financial condition and operations of the Hunt Collateral. The directors of the General Partner and Placid will conduct such review for the purpose of maintaining an awareness of the Limited Partners' overall financial condition as related to the Hunt Commitment. Each of the Limited Partners will deliver to the General Partner accurate and complete personal financial statements from time to time upon request by the General Partner.

17. Representations and Warranties by the Limited Partners.

The representations and warranties of the Limited Partners contained in the Representation and Warranty Agreement shall be deemed to be incorporated herein by reference and shall inure to the benefit of the Partnership, the General Partner, and Placid. Each Partner represents and warrants that he has relied exclusively upon his own attorney and other advisors in negotiating, executing and delivering this Agreement.

18. Miscellaneous.

18.1 Notices. Any notice, payment, demand, offer, or communication required or permitted to be given by any provision of this Agreement shall be deemed to have been delivered and given for all purposes (i) if delivered personally to the party or to an officer or general partner of the party to whom the same is directed or (ii) whether or not the same is actually received, if sent by registered or certified mail, postage and charges prepaid, addressed as follows: if to the General Partner, at the address set forth on the signature page of this Agreement or to such other address as the General Partner may from time to time specify by written notice to the Limited Partners; and, if to a Limited Partner, at such Limited Partner's address set forth on the signature page hereof, or to such other address as such Limited Partner may from time to time specify by written notice to the General Partner. Any such notice shall be deemed to be given as of the date so delivered, if delivered personally, or as of the date on which the same was deposited in a regularly maintained receptacle for the deposit of United States mail, addressed and sent as aforesaid.

18.2 Section Captions. Section and other captions contained in this Agreement are for reference purposes only and are in no way intended to describe, interpret, define, or limit the scope, extent, or intent of this Agreement or any provision hereof.

18.3 Severability. Every provision of this Agreement is intended to be severable. If any term or provision hereof is illegal or invalid for any reason whatsoever, such illegality or invalidity shall not affect the validity of the remainder of this Agreement.

18.4 Amendments. Amendments to this Agreement may be made by the General Partner as and when the General Partner may deem such amendments necessary, advisable, or convenient to effect the purposes of the Partnership; provided, however, the General Partner may not amend this Agreement unless the requisite percentage of Partners consent thereto in accordance with the provisions of this Section 18.4 if such proposed amendment would modify or amend (i) the Limited Partner Percentages; (ii) the interest of the Limited Partners in the capital and profits of the Partnership, including their right to an allocation of the net income or net loss of the Partnership at the time and in the manner and amounts specified in Section 8.1 hereof and their right to a distribution of the Net Cash Flow at the time and in the manner and amounts specified in Section 8.2 hereof; or (iii) any other provision of this Agreement which by its express terms requires the approval of any or all of the Limited Partners. Amendments to this Agreement which require the approval of any or all of the Limited Partners as set forth above may be proposed by the General Partner or by Limited Partners having an aggregate Limited Partner Percentage of twenty-five percent (25%) or more. Following such proposal, the General Partner shall submit to the Partners a verbatim statement of any proposed amendment and shall include in any such submission its recommendation as to the proposed amendment. The General Partner shall seek the written vote of the Partners on the proposed amendment or shall call a meeting of the Partners to vote thereon. For purposes of obtaining a written vote, the General Partner may require response within a specified time, but not less than thirty (30) days, and failure to respond in such time period shall constitute a vote which is consistent with the General Partner's recommendation with respect to the proposal. Any such proposed amendment shall be adopted and effective as an amendment hereto if it receives the affirmative vote of Limited Partners having an aggregate Limited Partner Percentage which is greater than eighty percent (80%) and if it receives the written approval of the General Partner.

18.5 Meetings and Means of Voting. Meetings of the Partners may be called by the General Partner or by Limited Partners having an aggregate Limited Partner Percentage of twenty-five percent (25%) or more. The call shall state the reason for calling the meeting. Notice of any such meeting shall be delivered to all Partners in the manner prescribed in Section 18.1 hereof not less than seven (7) days nor more than thirty (30) days prior to the date of such meeting. Partners may vote in person or by proxy at any such meeting and may waive any required notice thereof. Whenever the vote or consent of Partners is permitted or required under this Agreement, such vote or consent may be given at a meeting of Partners or may be given in writing in accordance with the procedure for obtaining written votes prescribed in Section 18.4 hereof.

18.6 Right to Rely Upon the Authority of General Partner. No person dealing with the General Partner shall be required to determine its authority to make any commitment or undertaking on behalf of the Partnership, nor to determine any fact or circumstance bearing upon the existence of its authority. In addition, no purchaser of any asset owned by the Partnership shall be required to determine the sole and exclusive authority of the General Partner to sign and deliver on behalf of the Partnership any such instrument of transfer, or to see to the application or distribution of revenues or proceeds paid or credited in connection therewith, unless such purchaser shall have received written notice from the Partnership affecting the same.

18.7 Litigation. The General Partner shall prosecute and defend such actions at law or in equity as may be necessary to enforce or protect the interests of the Partnership. The Partnership and the General Partner shall respond to any final decree, judgment, or decision of any court, board, or authority having jurisdiction in the premises. The General Partner shall satisfy any such judgment, decree, or decision first out of any insurance proceeds available therefor, next out of the assets of the Partnership, and finally out of the assets of the General Partner.

18.8 Texas Law. The local, internal laws of Texas shall govern the validity of this Agreement, the construction of its terms, and the interpretation of the rights and duties of the parties hereto.

18.9 Ownership; Waiver of Action for Partition. The interest of each Partner in the Partnership shall be personal property for all purposes. All property and interests in property, real or personal, owned by the Partnership shall be deemed owned by the Partnership as an entity, and no Partner, individually, shall have any ownership of such property or interest owned by the Partnership except as tenants in limited partnership. Each of the parties hereto irrevocably waives, during the term of the Partnership and during the period of its liquidation following any dissolution, any right that it may have to maintain any action for partition with respect to any of the assets of the Partnership.

18.10 Counterpart Execution. This Agreement may be executed in any number of counterparts with the same effect as if all parties hereto had signed the same document. All counterparts shall be construed together and shall constitute one Agreement.

18.11 Parties in Interest. Subject to the provisions contained in Section 10 hereof, each and every covenant, term, provision, and agreement herein contained shall be binding upon and inure to the benefit of the parties hereto, their respective heirs, (including any person taking by reason of, or in default of, exercise of any power of appointment by him), executors, administratiors, personal representatives, successors and assigns.

18.12 Time. Time is of the essence with respect to this Agreement.

18.13 Maintenance of Net Worth by General Partner. The General Partner agrees that during the term of the Partnership, the General Partner shall maintain a net worth, exclusive of its interest in the Partnership, in an amount equal to the greater of $250,000 or 10% of the aggregate contributions made by the Limited Partners to the capital of the Partnership, such net worth to be computed based upon the fair market value of the General Partner's assets. It is understood that such net worth shall be maintained by the General Partner owning a note payable to it by Placid in the form of Exhibit J hereto, and that pursuant to the Multi-Bank Loan Documents, Placid shall be obligated to maintain the net worth of the General Partner in accordance with the terms and provisions of this Section 18.13.

18.14 Certain Rights of Banks. The parties hereto acknowledge that the General Partner has guaranteed payment of the Multi-Bank Loan and, as a result thereof, has bound itself to the covenants in the Multi-Bank Loan Documents, which provide, among other things that:

18.14.1 Financial and other statements of the Partnership will be provided pursuant to Section 6.1 of the Revolving Credit Agreement;

18.14.2 The Partnership may not be liquidated, dissolved, merged, or consolidated, nor may assets be sold, except as permitted by Sections 6.2 and 6.3 of the Revolving Credit Agreement;

18.14.3 The Partnership may not create debts and liens except as permitted by Sections 6.4 and 6.6 of the Revolving Credit Agreement;

18.14.4 Distributions and investments may not be made by the Partnership except as permitted by Section 6.7 of the Revolving Credit Agreement; and

18.14.5 No waiver or consent under, and no amendment or modification of, this Agreement is permitted except as stated in Section 6.8 of the Revolving Credit Agreement.

18.15 Additional Documents. The Limited Partners agree promptly to furnish, execute and deliver such additional documents as the General Partner may request in order to (i) carry out the business and purpose of the Partnership; (ii) transfer, assign and convey the Contributed Assets to the Partnership; and (iii) perform their obligations as set forth herein.

IN WITNESS WHEREOF, this Agreement of Limited Partnership has been executed as of the date first above written.

GENERAL PARTNER:

PLACID INVESTMENT COMPANY,
a Delaware corporation

Residence Address:

1600 First National Bank Building
Dallas, Texas 75202

By ______________________
Walter Fraker, Vice President

STATE OF TEXAS §
§
COUNTY OF DALLAS §

SUBSCRIBED AND SWORN TO before me by the aforesaid Walter Fraker, Vice President of Placid Investment Company this 22nd day of May, 1980.

Notary Public in and for
Dallas County, Texas

My Commission Expires:

LIMITED PARTNERS:

Residence Address:

4500 Lakeside Drive
Dallas, Texas

Nelson Bunker Hunt

Residence Address:

4205 McFarlin
Dallas, Texas

WH Hunt
William Herbert Hunt

Residence Address:

10300 Gaywood
Dallas, Texas

Lamar Hunt

STATE OF TEXAS §
§
COUNTY OF DALLAS §

SUBSCRIBED AND SWORN TO before me by the aforesaid Nelson Bunker Hunt, William Herbert Hunt, and Lamar Hunt this 22nd day of May, 1980.

Notary Public in and for
Dallas County, Texas

My Commission Expires:

EXHIBIT A

ATTACHED TO AND MADE A PART OF
AGREEMENT OF
LIMITED PARTNERSHIP OF
PLACID INVESTMENTS, LTD.

Limited Partner Percentages

Limited Partner and Residence Address	Limited Partner Percentage
Nelson Bunker Hunt 4508 Lakeside Drive Dallas, Texas	59%
William Herbert Hunt 4205 McFarlin Dallas, Texas	40%
Lamar Hunt 10300 Gaywood Dallas, Texas	1%

EXHIBITS B AND C (Continued)
ATTACHED TO AND MADE A PART OF
AGREEMENT OF LIMITED PARTNERSHIP OF
PLACID INVESTMENTS, LTD.

Description of Contributed Assets/
Agreed Contribution Values of Contributed Assets

Agreed Contribution Values (000's)

NORTH DAKOTA COAL PROPERTIES

Estimated 1,900,000,000 Tons of Lignite

County	Net Acres
Williams	27,441.31
Ward	486.38
McHenry	280.00
McKenzie	9,830.00
Dunn	283.00
Golden Valley	4,878.47
Billings	6,621.38
Stark	14,434.03
Morton	65,763.11
Slope	20.00
Hettinger	1,440.00
Grant	11,183.70
	137,733.44

N. B. Hunt 50%	$ 147,000	
W. H. Hunt 50%	147,000	$ 294,000

GOLD STOCKS

Description	N. B. Hunt # of Shares	Agreed Contribution Values (000's)	W. H. Hunt # of Shares	Agreed Contribution Values (000's)	
Impala Platinum Holding	—	—	10,000	39	
Anglo American Gold Investment Co. Ltd.	7,300	377	7,300	377	
Blyvooruitzicht Gold Mining Co. Ltd.	4,200	39	4,200	39	
Buffelsfontein Gold Mining Co. Ltd.	178,938	8,363	11,936	418	
Doornfontein Gold Mining Co. Ltd.	19,038	868	7,750	183	
Durban Roodepoort Deep Ltd.	36,700	937	36,400	1,998	
East Driefontein Gold Mining Co. Ltd.	118,137	3,063	14,736	354	
East Rand Proprietary Mines Ltd.	33,000	898	33,300	888	
Eastern Transvaal Consolidated Mines Ltd.	6,200	29	13,200	124	
Elsburg Gold Mining Co. Ltd.	39,700	138	—	—	
Free State Geduld Mines	137,933	7,181	9,047	138	
Free State Saaiplaas Gold Mining Co. Ltd.	30,330	118	30,730	130	
Grootvlei Proprietary Mines Ltd.	110,275	963	75,200	649	
Harmony Gold Mining Co. Ltd.	122,703	2,485	13,200	279	
Hartebeestfontein Gold Mining Co. Ltd.	27,700	1,743	9,730	614	
Kloof Gold Mining Co. Ltd.	133,244	4,483	42,434	1,203	
Libanon Gold Mining Co. Ltd.	100,130	2,237	7,700	129	
Loraine Gold Mines Ltd.	106,700	707	62,200	331	
Marievale Consolidated Mines Ltd.	74,000	313	37,000	137	
President Brand Gold Mining Co. Ltd.	153,753	6,074	31,767	1,138	
Rand Mines Properties Ltd.	105,000	319	112,600	349	
Randfontein Estates Gold Mining Co. Witwatersrand Ltd.	69,428	4,326	23,000	1,444	
South African Land and Exploration Co. Ltd.	38,100	168	36,000	114	
South Roodepoort Main Reef Areas Ltd.	28,300	124	16,300	130	
Southvaal Holdings Ltd.	127,099	2,843	53,600	1,112	
Stilfontein Gold Mining Co. Ltd.	94,300	1,637	41,000	713	
Vaal Reefs Exploration and Mining Co. Ltd.	79,005	1,933	11,795	664	
Venterspost Gold Mining Co. Ltd.	95,100	1,177	67,100	830	
Village Main Reefs Gold Mining Co. Ltd.	21,000	31	22,700	31	
Vlakfontein Gold Mining Co. Ltd.	101,100	184	86,000	142	
Welkom Gold Mining Co. Ltd.	1,000	13	—	—	
West Driefontein Gold Mining Co. Ltd.	67,381	4,938	3,099	373	
West Rand Consolidated Mines Ltd.	74,460	454	27,000	243	
Western Areas Gold Mining Co. Ltd.	232,400	1,093	1,000	8	
Western Deep Levels Ltd.	141,186	4,843	9,714	333	
Western Holdings Ltd.	30,742	3,449	3,750	396	
Winkelhaak Mines Ltd.	175,177	4,340	29,000	749	
Witwatersrand Nigel Ltd.	31,300	63	129,600	332	
Zandpan Gold Mining Co. Ltd.	7,300	77	7,300	77	
President Steyn Gold Mining Co. Ltd.	102,843	6,151	31,290	1,183	
St. Helena Gold Mines Ltd.	—	—	2,000	67	
Leslie Gold Mines	—	—	20,000	432	
		77,079		25,341	$ 102,420

EXHIBITS B AND C
Page Two

SILVER Description	Receipts Held By	N. B. HUNT Ounces	Deemed Contribution Value (000's)	W. H. HUNT Ounces	Deemed Contribution Value (000's)	Deemed Contribution Value (000's)
Bullion	ACLI International	7,133,869	$ 100,230	3,880,963	$ 54,518	
"	Swiss Bank Corp.	8,250,402	115,918	9,538,170	134,011	
"	Citibank	—	—	1,300,662	18,274	
"	Placid	218,100	3,052	108,100	1,519	
"	London	30,000	422	—	—	
"	Merrill Lynch	—	—	8,219,300	115,483	
Bags of Coins	Swiss Bank Corp.	28,690	402	25,750	362	
"	Citibank	1,443,490	20,309	1,443,490	20,289	
"	Placid	167,020	2,347	152,720	2,146	
		17,273,551	$242,693	24,461,440	$366,774	$609,467
		N. B. Hunt		W. H. Hunt		
GOLD COINS						
5000 Austrian Coronas	Schroder Wagg		$ 2,700			$ 2,700
SILVER FORWARD CONTRACTS (Net Equity)						
(See Schedules B-1 and B-2 for details of contracts)						
	Swiss Bank Corp.		$16,402		$ 16,402	
	ACLI International		3,573		825	
	Merrill Lynch		1,506		1,498	
(Contributed Assets include the contracts and all margin and deposits)			$21,481		$ 18,725	$ 40,206
COMEX MARGIN DEPOSITS						
	Held by Merrill Lynch				$ 19,000	$ 19,000
CASH CONTRIBUTION BY LAMAR HUNT						1
						$1,264,094

SUMMARY OF CONTRIBUTED ASSET VALUES (000's)

N. B. HUNT	$ 605,952
W. H. HUNT	$ 658,141
LAMAR HUNT	$ 1
	$1,264,094

Schedule B-1 to
Exhibits B and C (Combined)

N. B. HUNT
FORWARD CONTRACTS
MAY 21, 1980

Maturity Date	# of Ounces (000's)	Price Per Oz.	Total Delivery Price	Value (1) Per Ounce	Total Value
Swiss Bank Corporation					
5/23/80	250	14.21	3,552,500	14.24	3,560,000
5/29/80	500	14.18	7,090,000	14.18	7,090,000
6/2/80	125	13.17	1,646,250	14.10	1,762,500
6/3/80	250	36.28	9,070,000	14.32	3,580,000
6/3/80	83.3	37.15	3,095,821	14.32	1,193,329
6/4/80	125	13.17	1,646,250	14.12	1,765,000
6/9/80	125	38.18	4,772,500	14.36	1,795,000
6/13/80	1,000	13.14	13,140,000	14.175	14,175,000
6/14/80	583.3	13.14	7,664,996	14.18	8,271,662
6/19/80	116.7	12.63	1,473,504	14.22	1,659,005
	3,158.3	17.77	53,151,821	14.20	44,851,496
Merrill Lynch					
7/21/80	444	14.847	6,592,068	14.65	6,504,600
7/21/80	140	14.15	1,981,000	14.65	2,051,000
	584	14.68	8,573,068	14.65	8,555,600
ACLI					
8/1/80	1,100	12.59	13,849,000	14.126	15,538,600
8/1/80	330	12.59	4,154,700	14.13	4,662,900
	1,430	12.59	18,003,700	14.127	20,201,500
	5,172.3	$ 15.41	$ 79,728,589	$ 14.23	$ 73,608,596

(1) Based on $14.05/oz. plus 10% per annum from 4/25/80 to original maturity date as per agreement.

Schedule B-2 to
Exhibits B and C (Combined)

W. H. HUNT
FORWARD CONTRACTS
MAY 21, 1980

Maturity Date	# of Ounces (000's)	Price Per Oz.	Total Delivery Price	Value (1) Per Ounce	Total Value
Swiss Bank Corporation					
5/23/80	250	14.21	3,552,500	14.24	3,560,000
5/29/80	500	14.18	7,090,000	14.18	7,090,000
6/2/80	125	13.17	1,646,250	14.10	1,762,500
6/3/80	250	36.28	9,070,000	14.32	3,580,000
6/3/80	83.3	37.15	3,095,821	14.32	1,193,329
6/4/80	125	13.17	1,646,250	14.12	1,765,000
6/9/80	125	38.18	4,772,500	14.36	1,795,000
6/13/80	1,000	13.14	13,140,000	14.175	14,175,000
6/14/80	583.3	13.14	7,664,996	14.18	8,271,662
6/19/80	116.7	12.63	1,473,504	14.22	1,659,005
	3,158.3	16.83	53,151,821	14.20	44,851,496
Merrill Lynch					
7/31/80	443	14.847	6,577,221	14.65	6,489,950
7/31/80	140	14.15	1,981,000	14.65	2,051,000
	583	14.68	8,558,221	14.65	8,540,950
ACLI					
8/1/80	330	12.59	4,154,700	14.126	4,661,580
	4,071.3	$ 16.18	$ 65,864,742	$ 14.26	$ 58,054,026

(1) Based on $14.05/oz. plus 18% per annum from 4/25/80 to original maturity date as per agreement.

EXHIBIT D

ATTACHED TO AND MADE A PART OF
AGREEMENT OF
LIMITED PARTNERSHIP OF
PLACID INVESTMENTS, LTD.

Description of Hunt Collateral

The "Hunt Collateral" is the Special Collateral Account (as defined in the Hunt Brothers' Guaranty) and all of the assets of the Limited Partners (or any of them) described in the Asset Summary (referred to in Section 2.1(a) of the Representation and Warranty Agreement) except the following assets (all of which will be pledged or mortgaged as part of the Hunt Collateral as soon as feasible, other than item 3 below):

1. The assets described on Exhibits B and K hereto.

2. The following numismatic coins which W. H. Hunt has agreed to purchase from Numismatic Fine Arts, Inc. ("NFA"), 342 North Rodeo Drive, Beverly Hills, California 90212, which are still in the possession of NFA, and which W. H. Hunt will be entitled to deliver to the Agents for Placid's Banks when the purchase price has been fully paid:

   (i) The coins described on NFA Invoice No. 5989 attached to Exhibit G of the Hunt Brothers' Guaranty.

   (ii) The coins described on NFA Invoice No. 5984 attached to Exhibit G of the Hunt Brothers' Guaranty.

   (iii) The coins described on NFA Invoice No. 3815 attached to Exhibit G of the Hunt Brothers' Guaranty.

3. Personal residence of each of the Limited Partners

4. The following numismatic coins which N. B. Hunt has agreed to purchase from NFA, which are still in the possession of NFA, and which N. B. Hunt will be entitled to deliver to the Agents for Placid's Banks when the purchase price has been fully paid:

   (i) The coins described on NFA Invoice No. 7000 attached to Exhibit G of the Hunt Brothers' Guaranty.

   (ii) The coins described on NFA Invoice No. 3939 attached to Exhibit G of the Hunt Brothers' Guaranty.

5. Real property and other assets in France, Australia, and New Zealand owned by N. B. Hunt

6. All of the Capital Stock of Kansas City Chiefs Football Club, Inc.

EXHIBIT A

ATTACHED TO AND MADE A PART OF AGREEMENT OF
LIMITED PARTNERSHIP OF PLACID INVESTMENTS, LTD.

Description of Partnership Debt
(Balances in $000's as of April 30, 1980)

Lender	Date of Note	Original Amount	Final Maturity/ Due Date	Interest Rate (Note 1)	Outstanding Balance
N. B. HUNT					
Citibank	3/80	$ 25,000	Demand	Prime + 1%	$ 17,500
Schroder Wagg Bank	11/78	367	Demand	13-5/8%	367
Swiss Bank Corporation	3/80	100,000	Demand	Prime + 1%	77,389
ACLI International	4/80	51,555	Demand	Prime + 1-7/8%	51,253
Broker Margin Accounts					
Merrill Lynch	Various	N/A	5/80	Prime + 1/2%	4,062
Placid Oil Company	4/22/80	159,370			159,370
TOTAL DEBT OF N. B. HUNT SUBJECT TO WHICH ASSETS ARE TRANSFERRED TO PARTNERSHIP					$310,323
W. H. HUNT					
Citibank	3/80	25,000	Demand	Prime + 1%	$ 17,500
Swiss Bank Corporation	3/80	100,000	Demand	Prime + 1%	89,468
ACLI International	4/80	38,103	5/80	Prime + 7/8%	38,103
Broker Margin Accounts					
Merrill Lynch	Various	N/A	5/80	Prime + 1/2%	71,336
Placid Oil Company	4/22/80	112,730	Demand		112,730
TOTAL DEBT OF W. H. HUNT SUBJECT TO WHICH ASSETS ARE TRANSFERRED TO PARTNERSHIP					$339,137
LAMAR HUNT					
TOTAL DEBT OF LAMAR HUNT SUBJECT TO WHICH ASSETS ARE TRANSFERRED TO PARTNERSHIP					$ - 0 -
TOTAL DEBT SUBJECT TO WHICH ASSETS ARE TRANSFERRED TO PARTNERSHIP					$649,460

Note (1) Interest is generally payable on a monthly or quarterly basis.

EXHIBIT F

ATTACHED TO AND MADE A PART OF AGREEMENT OF LIMITED PARTNERSHIP OF PLACID INVESTMENTS, LTD.

Security Documents

1. **The following Security Documents were executed by Lamar Hunt.**

The following Security Documents covering Hunt Collateral are to be executed by Lamar Hunt dated as of May 22, 1980:

a. Amended, Supplemented and Restated Supplemental Deed of Trust (With Security Agreement and Financing Statement) conveying to Walter Fraker, as Trustee, certain fee properties, easements and/or surface leases located in:

Missouri

b. Act of Collateral Mortgage conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain fee properties, easements and/or surface leases located in:

Louisiana

c. Amended, Supplemented and Restated Supplemental Deed of Trust, Security Agreement and Assignment of Production conveying to Walter Fraker, as Trustee, certain oil, gas and mineral interests located in:

Alaska

d. Amended, Supplemented and Restated Supplemental Mortgage, Assignment and Security Agreement conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, the certain oil, gas and mineral interests in:

North Dakota
Montana
Utah

e. Act of Collateral Mortgage and Assignment of Production conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain oil, gas and mineral interests (including offshore) located in:

Louisiana

f. Amended, Supplemented and Restated Supplemental Deed of Trust, Security Agreement and Assignment of Production conveying to Walter Fraker, as Trustee, certain geothermal leasehold interests located in:

Nevada
New Mexico

g. Amended, Supplemented and Restated Supplemental Mortgage, Assignment and Security Agreement conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain geothermal leasehold interests located in:

Idaho
Oregon

h. Amended, Supplemented and Restated Supplemental Deed of Trust, Assignment and Security Agreement conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain geothermal leasehold interests in:

New Mexico
Nevada

i. Collateral Mortgage Note payable to the order of Bearer and secured by items b. and e. above, together with Act of Pledge pledging Collateral Mortgage Note to Placid Investments, Ltd. and Placid Investment Company and repledging Collateral Mortgage Note (dated April 5, 1980) to Placid Oil Company.

j. Deed of Trust, Security Agreement and Assignment of Production conveying to Walter Fraker, as trustee, certain oil, gas and mineral interests located in:

Texas

k. Mortgage, Assignment and Security Agreement conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain oil, gas and mineral interests in:

North Dakota

l. Security Agreement granting to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation a security interest in the Hunt Collateral.

LH

m. Financing Statements (Form UCC-1) covering the Hunt Collateral to be filed under the Uniform Commercial Code in:

(i) Central filing office of all states (excluding Georgia, Nebraska and Louisiana) and the District of Columbia;

(ii) Local filing in all jurisdictions (excluding Louisiana) in which instruments described in items a. through h. are filed; and

(iii) Cook County, Illinois, Jackson County, Missouri.

1. **The following Security Documents were executed by Nelson Bunker Hunt.**

The following Security Documents covering Hunt Collateral are to be executed by Nelson Bunker Hunt dated as of May 22, 1980:

a. Amended, Supplemented and Restated Supplemental Deed of Trust (With Security Agreement and Financing Statement) conveying to Walter Fraker, as Trustee, certain fee properties, easements and/or surface leases located in:

Alaska
California
Mississippi
Texas
Tennessee

b. Amended, Supplemented and Restated Supplemental Mortgage and Security Agreement conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain fee properties, easements and/or surface leases located in:

Florida
Kentucky
Montana
Oklahoma

c. Act of Collateral Mortgage conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain fee properties, easements and/or surface leases located in:

Louisiana

d. Amended, Supplemented and Restated Supplemental Deed of Trust, Security Agreement and Assignment of Production conveying to Walter Fraker, as Trustee, certain oil, gas and mineral interests located in:

Texas
Alaska
Mississippi
New Mexico

e. Amended, Supplemented and Restated Supplemental Mortgage, Assignment and Security Agreement conveying to Placid Investments, Ltd., a Texas limited partnership, Placid

Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, the certain oil, gas and mineral interests in:

Arkansas
North Dakota
Oklahoma
Alabama
Montana
Michigan

f. Act of Collateral Mortgage and Assignment of Production conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain oil, gas and mineral interests (including offshore) located in:

Louisiana

g. Amended, Supplemented and Restated Supplemental Deed of Trust, Security Agreement and Assignment of Production conveying to Walter Fraker, as Trustee, certain geothermal leasehold interests located in:

Nevada
New Mexico

h. Amended, Supplemented and Restated Supplemental Mortgage, Assignment and Security Agreement conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain geothermal leasehold interests located in:

Idaho
Utah

i. Amended, Supplemented and Restated Supplemental Deed of Trust, Assignment and Security Agreement conveying to Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain geothermal leasehold interests in:

New Mexico

j. Collateral Mortgage Note payable to the order of Bearer and secured by items c. and f. above, together with Act of Pledge pledging Collateral Mortgage Note to Placid Investments, Ltd. and Placid Investment Company and repledging Collateral Mortgage Note (dated April 5, 1980) to Placid Oil Company.

k. Security Agreement granting to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation a security interest in the Hunt Collateral.

l. Financing Statements (Form UCC-1) covering the Hunt Collateral to be filed under the Uniform Commercial Code in:

(i) Central filing office of all states (excludes Georgia, Nebraska and Louisiana) and the District of Columbia;

(ii) Local filing in all jurisdictions (excluding Louisiana) in which instruments described in items a. through i. are filed; and

(iii) Los Angeles and San Bernadino Counties, California, Weschester and New York Counties, New York, Bourbon County, Kentucky, Finney County, Kansas, Cook County, Illinois, Levy and Marion Counties, Florida, and Weld County, Colorado.

3. The following Security Documents were executed by William Herbert Hunt.

The following Security Documents covering Hunt Collateral are to be executed by William Herbert Hunt dated as of May 22, 1980:

a. Amended, Supplemented and Restated Supplemental Deed of Trust (With Security Agreement and Financing Statement) conveying to Walter Fraker, as Trustee, certain fee properties, easements and/or surface leases located in:

Texas

b. Amended, Supplemented and Restated Supplemental Mortgage and Security Agreement conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain fee properties, easements and/or surface leases located in:

Colorado

c. Act of Collateral Mortgage conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain fee properties, easements and/or surface leases located in:

Louisiana

d. Amended, Supplemented and Restated Supplemental Deed of Trust, Security Agreement and Assignment of Production conveying to Walter Fraker, as Trustee, certain oil, gas and mineral interests located in:

Texas
Alaska
Mississippi
New Mexico

e. Amended, Supplemented and Restated Supplemental Mortgage, Assignment and Security Agreement conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, the certain oil, gas and mineral interests in:

Arkansas
North Dakota
Oklahoma
Wyoming
Montana
Michigan

f. Act of Collateral Mortgage and Assignment of Production conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain oil, gas and mineral interests (including offshore) located in:

Louisiana

g. Amended, Supplemented and Restated Supplemental Deed of Trust, Security Agreement and Assignment of Production conveying to Walter Fraker, as Trustee, certain geothermal leasehold interests located in:

Nevada
New Mexico

h. Amended, Supplemented and Restated Supplemental Mortgage, Assignment and Security Agreement conveying to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain geothermal leasehold interests located in:

Idaho
Utah
North Dakota
Nevada
Oregon

i. Amended, Supplemented and Restated Supplemental Deed of Trust, Assignment and Security Agreement conveying to Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation, certain geothermal leasehold interests in:

New Mexico

j. Collateral Mortgage Note payable to the order of Bearer and secured by items c. and f. above, together with Act of Pledge pledging Collateral Mortgage Note to Placid Investments, Ltd. and Placid Investment Company and repledging Collateral Mortgage Note (dated April 5, 1980) to Placid Oil Company.

k. Security Agreement granting to Placid Investments, Ltd., a Texas limited partnership, Placid Investment Company, a Delaware corporation, and Placid Oil Company, a Delaware corporation a security interest in the Hunt Collateral.

1. Financing Statements (Form UCC-1) covering the Hunt Collateral to be filed under the Uniform Commercial Code in:

    (i) Central filing office of all states (excluding Georgia, Nebraska and Louisiana) and the District of Columbia;

    (ii) Local filing in all jurisdictions (excluding Louisiana) in which instruments described in items a. through i. are filed; and

    (iii) Los Angeles and San Bernadino Counties, California, Weschester and New York Counties, New York, Cook County, Illinois.

EXHIBIT G

ATTACHED TO AND MADE A PART OF
AGREEMENT OF
LIMITED PARTNERSHIP OF
PLACID INVESTMENTS, LTD.

Worksheet for Calculation of Periodic Contribution Amount

Calculation as of ________________, 19_____ ("Date")

ADD:

(i)	**General Partner's Unpaid Primary Preference:**			
	General Partner's Aggregate Primary Preference to Date		**$_______**	
	Less: Aggregate cash distributed to General Partner to Date under Section 8.2.1		**$_______**	**$_______**
(ii)	**Limited Partners' Unpaid Primary Preference:**			
	Limited Partners' Aggregate Primary Preference to Date		**$_______**	
	Less: Aggregate cash distributed to Limited Partners to Date under Section 8.2.2		**$_______**	**$_______**
(iii)	**Aggregate Pay Down as of Date (Note 1)**			**$_______**
	SUB TOTAL			**$_______**

SUBTRACT:

(a)	**The Stated Amount, being** **$100,000,000 to Feb. 1982** **85,000,000 on last Business Day of Feb. 1982** **70,000,000 on last Business Day of May 1982** **55,000,000 on last Business Day of Aug. 1982** **40,000,000 on last Business Day of Nov. 1982** **20,000,000 on last Business Day of Feb. 1983** **-0- thereafter**	**(Minus)**	**$_______**
(b)	**Aggregate cash distributed to the General Partner prior to Date pursuant to Section 8.2.3**	**(Minus)**	**$_______**
(c)	**Undistributed Net Cash Flow on hand on Date (Note 2)**	**(Minus)**	**$_______**
	PERIODIC CONTRIBUTION AMOUNT		**$_______**

Note 1: **Aggregate Pay Down not to exceed 98% of the General Partner's Investment.**

Note 2: **Undistributed Net Cash Flow does not include the proceeds (up to $100,000,000) on hand, if any, to be distributed to the Limited Partners with respect to a sale of the Coal Properties. Also, undistributed Net Cash Flow on hand does not include the capital contributions to be made on Date by the Limited Partners with respect to the Periodic Contribution Amount.**

EXHIBIT H

Execution Copy

CERTIFICATE OF LIMITED PARTNERSHIP
OF
PLACID INVESTMENTS, LTD.

Pursuant to the provisions of the Texas Uniform Limited Partnership Act (the "Act"), the undersigned, desirous of forming a limited partnership under the Act, to be effective upon the filing of this Certificate of Limited Partnership in the Office of the Secretary of State of Texas, do hereby certify as follows:

(A) The name of the partnership is PLACID INVESTMENTS, LTD.

(B) The character of the business of the partnership is the ownership, holding, management, and orderly disposition of its investment assets and the ownership, holding, operation, and development of its coal assets.

(C) The location of the principal place of business of the partnership in Texas is 1600 First National Bank Building, Dallas, Texas 75202.

(D) The name and place of residence of the general partner is as follows:

Name	Residence Address
Placid Investment Company	1600 First National Bank Building Dallas, Texas 75202

The name and place of residence of each limited partner is as shown on Exhibit A attached hereto.

(E) The term for which the partnership is to exist is until December 31, 2030, unless sooner terminated because of the dissolution and winding up of the partnership.

(F) The amount of cash and the agreed value and description of other property agreed to be contributed by each limited partner is as shown on Exhibit A attached hereto.

(G) The additional contributions, if any, agreed to be made by each limited partner are as shown on Exhibit A attached hereto.

(H) There is no specified time for the return of the contribution of each limited partner.

(I) The share of the profits or the other compensation by way of income which each limited partner shall receive by reason of his contribution is as shown on Exhibit B attached hereto.

(J) No limited partner has any right to substitute an assignee as a contributor in his place.

(K) The partners do not have the right to admit additional limited partners.

May 20, 1980

EXHIBIT H

CERTIFICATE OF LIMITED PARTNERSHIP
OF
PLACID INVESTMENTS, LTD.

Pursuant to the provisions of the Texas Uniform Limited Partnership Act (the "Act"), the undersigned, desirous of forming a limited partnership under the Act, to be effective upon the filing of this Certificate of Limited Partnership in the Office of the Secretary of State of Texas, do hereby certify as follows:

(A) The name of the partnership is PLACID INVESTMENTS, LTD.

(B) The character of the business of the partnership is the ownership, holding, management, and orderly disposition of its investment assets and the ownership, holding, operation, and development of its coal assets.

(C) The location of the principal place of business of the partnership in Texas is 1600 First National Bank Building, Dallas, Texas 75202.

(D) The name and place of residence of the general partner is as follows:

Name	Residence Address
Placid Investment Company	1600 First National Bank Building Dallas, Texas 75202

The name and place of residence of each limited partner is as shown on Exhibit A attached hereto.

(E) The term for which the partnership is to exist is until December 31, 2030, unless sooner terminated because of the dissolution and winding up of the partnership.

(F) The amount of cash and the agreed value and description of other property contributed by each limited partner is as shown on Exhibit A attached hereto.

(G) The additional contributions, if any, agreed to be made by each limited partner are as shown on Exhibit A attached hereto.

(H) There is no specified time for the return of the contribution of each limited partner.

(I) The share of the profits or the other compensation by way of income which each limited partner shall receive by reason of his contribution is as shown on Exhibit B attached hereto.

(J) No limited partner has any right to substitute an assignee as a contributor in his place.

(K) The partners do not have the right to admit additional limited partners.

(L) No limited partner has any priority as to contributions or as to compensation by way of income.

(M) The partners do not have the right to continue the business of the partnership upon the dissolution, liquidation or bankruptcy of the general partner.

(N) No limited partner has the right to demand and receive property other than cash in return for his contribution.

IN WITNESS WHEREOF, this Certificate of Limited Partnership has been duly executed by the parties hereto effective as of April 28, 1980.

GENERAL PARTNER:

PLACID INVESTMENT COMPANY,
a Delaware corporation

By ______________________________
, President

STATE OF TEXAS §
§
COUNTY OF DALLAS §

SWORN TO AND SUBSCRIBED BEFORE ME by the aforesaid ______________________________ this _____ day of May, 1980.

(SEAL)

____
Notary Public in and for
Dallas County, Texas

LIMITED PARTNERS:

____
Nelson Bunker Hunt

____
William Herbert Hunt

____
Lamar Hunt

STATE OF TEXAS §
§
COUNTY OF DALLAS §

SWORN TO AND SUBSCRIBED BEFORE ME by the aforesaid NELSON BUNKER HUNT, WILLIAM HERBERT HUNT, AND LAMAR HUNT this ____ day of May, 1980.

(SEAL)

____
Notary Public in and for
Dallas County, Texas

EXHIBIT A
TO
CERTIFICATE OF LIMITED PARTNERSHIP
OF
PLACID INVESTMENTS, LTD.

NAME AND PLACE OF RESIDENCE	CONTRIBUTION	ADDITIONAL CONTRIBUTION
Nelson Bunker Hunt 4508 Lakeside Drive Dallas, Texas	Investment assets and coal properties subject to, but without assumption of, certain related debt, with a net equity valued at more than $249,500.	Additional contributions may occur from time to time under certain circumstances; if they do occur, the amounts and dates of such contributions cannot be determined at this time; an amendment to this Certificate of Limited Partnership setting forth the amount of such contributions will be filed when such contributions are made.
William Herbert Hunt 4205 McFarlin Dallas, Texas	Investment assets and coal properties subject to, but without assumption of, certain related debt, with a net equity valued at more than $249,500.	Additional contributions may occur from time to time under certain circumstances; if they do occur, the amounts and dates of such contributions cannot be determined at this time; an amendment to this Certificate of Limited Partnership setting forth the amount of such contributions will be filed when such contributions are made.
Lamar Hunt 10300 Gaywood Dallas, Texas	Cash and other property valued at more than $1,000.	Additional contributions may occur from time to time under certain circumstances; if they do occur, the amounts and dates of such contributions cannot be determined at this time; an amendment to this Certificate of Limited Partnership setting forth the amount of such contributions will be filed when such contributions are made.

EXHIBIT B
TO
CERTIFICATE OF LIMITED PARTNERSHIP
OF
PLACID INVESTMENTS, LTD.

The share of the profits or the other compensation by way of income which each limited partner shall receive by reason of his contribution cannot be determined because distributions, if any, to the limited partners are contingent upon certain prior distributions to the general partner. Any distributions made to the limited partners will be made 59% to Nelson Bunker Hunt, 40% to William Herbert Hunt, and 1% to Lamar Hunt. Such distributions to the limited partners will be made upon the following bases and in the following order of priority:

(1) First, to the general partner, until the General Partner's Unpaid Primary Preference is reduced to zero.

(2) Second, to the limited partners, until the Limited Partners' Unpaid Primary Preference is reduced to zero.

(3) Third, to the general partner, as a return of capital, until the General Partner's Unrecovered Contribution is equal to two percent (2%) of the General Partner's Investment.

(4) Fourth, to the general partner, as a return of capital, until the General Partner's Unrecovered Contribution is reduced to zero.

(5) Fifth, to the general partner, until the General Partner's Unpaid Secondary Preference is fully paid.

(6) Sixth, to the limited partners, until the Limited Partners' Unpaid Secondary Preference is reduced to zero.

(7) Seventh, to the limited partners, as a return of capital, until the Limited Partners' Unrecovered Investment Contribution is reduced to zero.

(8) Eighth, to the limited partners, as a return of capital, until the Limited Partners' Unrecovered Coal Contribution is reduced to zero; provided, however, that the aggregate amount of cash that may be distributed to the limited partners under this subparagraph (8) may in no event exceed the aggregate amount of net cash proceeds previously realized by the partnership from or in respect of operations or sale of the coal properties.

(9) Ninth, the remaining distributions, if any, shall be made fifty percent (50%) to the general partner and fifty percent (50%) to the limited partners.

The defined terms utilized above and other defined terms utilized therein have the following meanings:

EXHIBIT B (CONT.)
TO
CERTIFICATE OF LIMITED PARTNERSHIP
OF
PLACID INVESTMENTS, LTD.

"General Partner's Investment" as of any particular date shall mean the total of all contributions to the capital of the partnership by the general partner as of such date other than with respect to coal assets.

"General Partner's Aggregate Primary Preference" as of any particular date means the aggregate amount of the General Partner's Primary Preference computed from the date of the formation of the partnership through the date in question.

"General Partner's Unpaid Primary Preference" as of any particular date means the excess of the General Partner's Aggregate Primary Preference as of such date over the aggregate amount of cash distributed to the general partner pursuant to subparagraph (1) above.

"General Partner's Unpaid Secondary Preference" as of any particular date means the amount required to be distributed to the general partner on such date in order to provide to the general partner an effective 26.1053% per annum rate of return or yield on the General Partner's Unrecovered Contribution computed by giving effect to the timing and amount of contributions to the capital of the partnership by the general partner with respect to non-coal assets and after giving effect to the timing and amount of distributions to the general partner pursuant to subparagraphs (1), (3), (4), and (5) above.

"General Partner's Primary Preference" for any period means an amount equal to the product of the Primary Preference Rate (adjusted for the length of the period involved on the basis of a 365 day year) times the daily average outstanding balance of the General Partner's Unrecovered Contribution during such period.

"General Partner's Unrecovered Contribution" means the aggregate amount contributed by the general partner to the capital of the partnership reduced by cash distributions to the general partner from the partnership pursuant to subparagraphs (3) and (4) above.

"Limited Partners' Aggregate Primary Preference" as of any particular date means the aggregate amount of the Limited Partners' Primary Preference computed from the date of the formation of the partnership through the date in question.

"Limited Partners' Aggregate Secondary Preference" as of any particular date means the aggregate amount of the Limited Partners' Secondary Preference computed from the date of the formation of the partnership through the date in question.

"Limited Partners' Unpaid Primary Preference" as of any particular date means the excess of the Limited Partners' Aggregate Primary Preference as of such date over the aggregate amount of cash distributed to the limited partners pursuant to subparagraph (2) above.

EXHIBIT B (CONT.)
TO
CERTIFICATE OF LIMITED PARTNERSHIP
OF
PLACID INVESTMENTS, LTD.

"Limited Partners' Unpaid Secondary Preference" as of any particular date means the excess of the Limited Partners' Aggregate Secondary Preference as of such date over the aggregate amount of cash distributed to the limited partners pursuant to subparagraphs (2) and (6) above.

"Limited Partners' Primary Preference" for any period means an amount equal to the product of the Primary Preference Rate (adjusted for the length of the period involved on the basis of a 365 day year) times the lesser of (i) the daily average outstanding balance of the Limited Partners' Unrecovered Investment Contribution during such period or (ii) the daily average unpaid principal balance of a certain promissory note during such period.

"Limited Partners' Secondary Preference" for any period means an amount equal to (i) the product of a rate equal to twenty-five percent (25%) per annum (adjusted for the length of the period involved on the basis of a 365 day year) times (ii) the daily average outstanding balance of the Limited Partners' Unrecovered Investment Contribution during such period.

"Limited Partners' Unrecovered Coal Contribution" means the aggregate amount contributed by the limited partners to the capital of the partnership with respect to coal assets reduced by cash distributions from the partnership pursuant to subparagraph (8).

"Limited Partners' Unrecovered Investment Contribution" means the aggregate amount contributed by the limited partners to the capital of the partnership with respect to non-coal assets reduced by cash distributions from the partnership pursuant to subparagraph (7) above.

"Primary Preference Rate" means a rate equal to eighteen percent (18%) per annum, so long as the amount against which such rate is applied equals or exceeds $25,000; and a rate equal to 10% per annum so long as the amount against which such rate is applied is less than $25,000.

EXHIBIT I

Attached To and Made a Part of
Agreement of Limited Partnership of Placid Investments, Ltd.

PROMISSORY NOTE

$10,000

Dallas, Texas
May 22, 1980

FOR VALUE RECEIVED, the undersigned, jointly and severally, promises to pay to the order of Placid Investments, Ltd. the principal sum of TEN THOUSAND AND NO/100 DOLLARS ($10,000), in lawful money of the United States, on March 1, 1991, without interest.

This Promissory Note may not be prepaid without the prior consent in writing of the holder of this Promissory Note.

Should the indebtedness represented by this Promissory Note or any part hereof be collected at law or in equity or in bankruptcy, receivership or other court proceedings or this Promissory Note be placed in the hands of attorneys for collection after default, the undersigned agrees to pay, in addition to the principal then due and payable hereon, reasonable attorneys' and collection fees.

IN WITNESS WHEREOF, the undersigned have executed this Promissory Note in Dallas, Texas, the date first above written.

N. B. Hunt

W. H. Hunt

Lamar Hunt

EXHIBIT J

Attached To and Made a Part of
Agreement of Limited Partnership of Placid Investments, Ltd.

CAPITAL NOTE

Dallas, Texas
May 22, 1980

FOR VALUE RECEIVED, the undersigned, PLACID OIL COMPANY, a Delaware corporation ("Company") hereby promises to pay to the order of PLACID INVESTMENT COMPANY, a Delaware corporation ("PIC") on demand from time to time as a contribution to the capital of PIC the greater of $250,000 or such amount or amounts as are necessary to maintain the net worth of PIC at all times at 10.01% of the contributions made by the Limited Partners to Placid Investments, Ltd., a Limited Partnership organized under the laws of Texas (the "Partnership"), together with interest thereon as herein provided. "Contributions" shall have the meaning as defined in Rev.Proc. 72-13, 1972-1 C.B. 735. Interest shall accrue as if funds were actually advanced herein at the times and in the amounts necessary to maintain the net worth as herein provided. Interest is payable on the last day of each March, June, September and December during the term hereof, and on the maturity hereof, at a rate per annum equal to the lesser of (i) the highest lawful rate, or (ii) a rate (calculated on the basis of actual days elapsed but computed as if each calendar year consisted of 360 days) equal to 1/2 of 1% above the base commercial rate of interest established from time to time by First National Bank in Dallas for short-term, unsecured loans to substantial and responsible commercial borrowers, as such rate shall change from time to time, each change in the rate to become effective on the effective date of such change without notice to Company. Both principal and interest are payable in lawful money of the United States of America at the office of PIC at 1600 Elm Street, Dallas, Texas 75202, in immediately available funds.

PLACID OIL COMPANY

By____________________________
Vice President

EXHIBIT K

Attached To and Made a Part of
Agreement of Limited Partnership of Placid Investments, Ltd.

Certain Brokers' Margin Accounts
May 1980

(Thousands of Dollars)

	N. B. HUNT				W. H. HUNT			
	Shares	Value	Loan	Equity	Shares	Value	Loan	Equity
Goldman Sachs								
Penn Central:								
Common	35,500	$ 604			35,500	$ 604		
Preferred B	25,500	128			166,500	853		
Preferred 5.27	50,000	2,181			50,000	2,181		
Columbia Pictures	16,700	524						
		3,437	1,872	1,565		3,638	2,021	1,617
Dean Witter Reynolds								
Global Marine	73,150	3,620			73,150	3,620		
Asamera	30,450	556			30,450	556		
		4,176	1,813	2,363		4,176	1,813	2,363
E. F. Hutton								
Global Marine	27,500	1,361	252	1,109	27,500	1,361	252	1,109
Bache								
Bache	288,350	2,451			288,250	2,450		
Silver Coins (150 bags)		799				799		
		3,250	(1)	3,250		3,249	(1)	3,249
Howard Weil								
Energy Reserves Group					100,000	1,175	606	569
Merrill Lynch								
Penn Central:								
Common	134,750	2,291			134,750	2,291		
Preferred 5.27	274,950	11,995			274,950	11,995		
		14,286	6,212	8,074		14,286	6,211	8,075

Notes:

(1) According to latest information from Bache, there is a potential balance due of $727 for all Hunt accounts combined. Zero liability is reflected because of various estimates by Bache and items in dispute.

D. BANK COMMITMENT LETTERS, VARIOUS DATES

BANK COMMITMENT LETTER

May 1, 1980

Placid Oil Company
1600 First National Bank Building
Dallas, Texas 75202

Gentlemen:

Subject to the conditions herein stated, the undersigned banks are willing to make loans to Placid Oil Company upon the following terms:

Borrower: Placid Oil Company ("Placid").

Agents: First National Bank in Dallas ("First in Dallas") and Morgan Guaranty Trust Company of New York ("Morgan").

Amount: $1,100,000,000

Lenders:

Bank	Amount
First in Dallas	$ 10,000,000
Morgan	$ 100,000,000
Citibank, N.A.	$ 200,000,000
The Chase Manhattan Bank (National Association)	$ 150,000,000
Bank of America National Trust and Savings Association	$ 100,000,000
Manufacturers Hanover Trust Company	$ 100,000,000

Continental Illinois National Bank and Trust Company of Chicago	$	80,000,000
Canadian Imperial Bank of Commerce	$	75,000,000
The Royal Bank of Canada	$	75,000,000
The First National Bank of Chicago	$	70,000,000
Chemical Bank	$	50,000,000
Bankers Trust Company	$	50,000,000
Republic National Bank of Dallas	$	40,000,000

Purposes: Proceeds of the loans will be used by Placid to enable it to fund the obligations of a Placid subsidiary in a Partnership (herein so called) to be formed between the subsidiary, as General Partner, and Nelson Bunker Hunt, William Herbert Hunt, and Lamar Hunt (the "Hunt Brothers"), as Limited Partners, upon the terms and conditions stated in a letter agreement (the "Partnership Commitment Letter") between Placid and the Hunt Brothers substantially in the form attached hereto, to renew certain interim advances by certain of the lenders, and for such other general corporate purposes as Placid may deem appropriate.

Drawdown: Reducing revolver through May 31, 1983, with mandatory reductions in commitment as follows:

> (a) The applicable Commitment Reduction Amount set forth in the annexed Schedule, on the last business day of each February, May, August and November in each year commencing November 30, 1980; and
>
> (b) Amount of mandatory prepayments (with, until the Cash Flow Maintenance Tests are first met, partial credit to future scheduled reductions, in the case of mandatory prepayments pursuant to clauses (a) and (b) under Mandatory Prepayments, so as to achieve ratable application over the full life

of the loan).

Repayment: Quarterly installments over a seven-and-one-half-year period on the last business day of each May, August, November and February in each year commencing August 31, 1983, in an amount equal to the applicable Amortization Percentage (set forth in the annexed Schedule) of the unpaid balance on May 31, 1983.

Mandatory Prepayments:

(a) Distributions from the Partnership to the General Partner;

(b) All payments received on the Hunt Brothers Note described in the Partnership Commitment Letter; and

(c) Proceeds of sales of collateral (to be shared ratably with 1979 Lenders in the case of collateral described in clause (a) of Collateral).

Optional Prepayments: Permitted at any time without penalty, in minimum amounts of $5,000,000.

Application of Prepayments on Term Loan:

(a) Optional prepayments applied ratably to installments.

(b) Mandatory prepayments applied to installments in inverse order of maturity.

Interest: Payable on the last business day of each February, May, August and November at a rate equal to

(a) until April 9, 1983, 103% of (Alternate Base plus 1/2%); and

(b) thereafter, 105% of (Alternate Base plus 1/2%).

Alternate Base will be defined as the greater of Adjusted Reserve Effective CD Rate plus 1/2% or Morgan Prime.

Fees:

(a) Commitment fee of 1/2% on unused portion commencing April 28, 1980.

(b) Fee in lieu of balances commencing April 28, 1980 equal to (i) until May 31, 1983, 5% of (Alternate Base X total commitments) and (ii) thereafter, 5% of (Alternate Base X outstanding principal balance).

(c) Demand note lenders to receive accrued commitment fees and fees in lieu of balances from April 9, 1980 on $800,000,000 total commitments (commitment fee net of $300,000,000 outstanding).

Collateral: (a) To be shared ratably with 1979 Lenders:

(i) All interests of Placid and subsidiaries in all engineered properties, including without limitation L/10-11 field in North Sea and Black Lake Field in Louisiana;

(ii) Refineries and related pipeline systems;

(iii) Pipeline system involved in present acquisition discussions;

(iv) DSM Note;

(v) Stock of all Placid subsidiaries (except stock of General Partner); and

(vi) Such other collateral as Majority Banks may require from time to time.

(b) To secure this debt only:

(i) Rights of General Partner under the Partnership Agreement contemplated by the Partnership Commitment Letter;

(ii) All assets of the Hunt Brothers securing the Hunt Brothers Guaranty contemplated by the Partnership Commitment Letter;

(iii) Stock of General Partner; and

(iv) Hunt Brothers Note.

Guarantors:

(a) All Placid subsidiaries requested by lenders; and

(b) The Hunt Brothers Guaranty contemplated by the Partnership Commitment Letter. The Hunt Brothers Guaranty shall include joint and several indemnities of the Hunt Brothers from any claims arising out of the contemplated transactions.

Representations and Warranties: Usual and customary, and such other representations and warranties as lenders may request. Lenders shall receive such information and certifications as they request to satisfy themselves as to the accuracy of all representations and warranties, including those made by the Hunt Brothers in the Partnership Agreement and the Hunt Brothers Guaranty.

Closing Conditions: Usual and customary, including:

(a) Satisfaction of the conditions and requirements stated in the Partnership Commitment Letter and in the definitive Partnership Agreement.

(b) Consummation of the settlement of the claims of Engelhard Minerals and Chemicals Corporation against the Hunt Brothers on a basis satisfactory to lenders.

(c) Satisfactory resolution of the IMIC relationship upon the terms stated in the Partnership Commitment Letter.

(d) Satisfaction with respect to state of title to, and perfection of liens on, major Placid properties and major properties of the Hunt Brothers.

(e) Consents of the adult beneficiaries (vested and contingent) and their spouses, trustees and advisory board members of the trusts (the "1935 trusts") which own the stock of Placid to the contemplated transactions.

(f) Satisfaction with respect to any material litigation or governmental proceedings pending or threatened against any of the Hunt Brothers or any Hunt Affiliate or Hunt

Entity (as defined in the Partnership Commitment Letter).

(g) Several indemnities of Margaret Hunt Hill and Caroline Hunt Schoellkopf from any claims by any of their respective descendants and from any person who may take from Haroldson L. Hunt, Jr.

(h) Several indemnities from each other adult beneficiary from any claims of any person who may take from him.

(i) Necessary waivers from other lenders.

(j) Other appropriate conditions and legal opinions.

Covenants (Placid Loan Agreement) (applicable to Placid, Subsidiaries and the Partnership):

(a) Financial statements:

(i) Audited annually; and

(ii) Unaudited quarterly.

(b) (i) Engineering reports and reviews annually, and (ii) cash flow reports quarterly, with all lenders having right to comment on assumptions and 51% of lenders having right to approve assumptions.

(c) Other information requested by lenders.

(d) Quarterly certificates of no default by officer of Placid and annual certificate of no default by independent accountants.

(e) No liquidations or dissolutions except into Borrower or Placid International Oil Ltd. ("PIOL").

(f) No mergers or sales of all or substantially all assets other than mergers if (i) no default will occur, and (ii) Placid, PIOL, or a guarantor subsidiary is the survivor. No mergers or sales of substantial assets by, with or to General Partner.

(g) No sales of collateral other than (i) hydrocarbons after severance in ordinary course, (ii) refined products in ordinary course and (iii) surplus equipment in ordinary course.

(h) Proceeds of sales of assets by Partnership distributable to the General Partner shall be applied as prepayments on this debt.

(i) No debt, except:

(i) This debt;

(ii) The debt ("1979 Debt") under the $450,000,000 Amended and Restated Loan Agreement among Placid and PIOL, as Borrowers, and 20 banks (the "1979 Lenders") including Agents, as lenders (such loan agreement and the contemplated new loan agreement, the proceeds from which will be used to discharge such debt, being herein called the "1979 Loan Agreement");

(iii) Other existing debt;

(iv) Intercompany debt;

(v) Additional pipeline debt not exceeding $30,000,000 representing purchase money debt in connection with a proposed acquisition of a gas gathering system in Louisiana;

(vi) After the Cash Flow Maintenance Tests are first met, Nonrecourse Secured Debt similar to that permitted under the 1979 Agreement as presently in effect; and

(vii) After the Cash Flow Maintenance Tests are first met, additional debt of Placid (but not any subsidiary), if, after giving effect thereto, the Cash Flow Maintenance Tests will be met.

(j) Cash Flow Maintenance Test (to become effective on May 31, 1983, or when first met, if earlier):

(i) Cash Flow from Engineered Properties for the life of such properties must equal or exceed 166% of Total Required Debt Service; and

(ii) Consolidated Cash Flow from All Operations in next 12 months must equal or exceed 125% of

Annual Required Debt Service.

This test, once effective, is required to be met prospectively for each year for the remaining term of the loans.

(k) Maintain, at all times prior to effectiveness of Cash Flow Maintenance Tests, Consolidated Cash Flow from All Operations in next 12 months equal to or exceeding 105% of Annual Required Debt Service.

(l) No liens except:

(i) Immaterial liens presently permitted;

(ii) Liens securing this debt and the 1979 Debt;

(iii) Liens on margin stock to secure existing margin debt;

(iv) Existing liens;

(v) Liens on the gas gathering system referred to in (i)(v) preceding to secure the debt referred to therein; and

(vi) Liens securing Nonrecourse Secured Debt permitted by (i)(vi) preceding.

(m) No dividends or distributions (other than distributions by the Partnership required under the Partnership Commitment Letter), or investments in Insiders, until Cash Flow Maintenance Tests are met, and thereafter only if (i) no default will exist and (ii) noncumulative dividends, distributions and investments during the year in question do not exceed 15% of consolidated net income after taxes for the preceding year.

(n) No acquisitions or investments other than (i) investments in the Partnership, not to exceed $1,100,000,000, (ii) other intercompany advances, (iii) the pipeline acquisition referred to in (i)(v) for a purchase price not exceeding $40,000,000, (iv) short-term money market investments, (v) payment of the $20,000,000 balance of the purchase price of HIPCO (UK), (vi) ordinary and necessary expenditures in connection with refining operations, lease acquisition and exploration and development activities, (vii) loans of up to

$25,000,000 to the Hunt Brothers as contemplated by the Partnership Commitment Letter, and (viii) others not exceeding $1,000,000 per year (noncumulative).

(o) Cause the General Partner to perform its obligations, and to require performance by Hunt Brothers of their obligations, under Partnership Agreement, and to enforce its rights thereunder.

(p) No amendments of or waivers under Partnership Agreement.

(q) No release of collateral securing additional contribution obligations of Hunt Brothers under Partnership Agreement or the Hunt Brothers Note unless (i) proceeds are used to retire this debt or (ii) Placid and Majority Banks have agreed to allow Hunt Brothers to retain proceeds, except as set forth in the Partnership Commitment Letter. Any sale of collateral permitted by such release shall be on arm's-length terms.

(r) No issuance of additional stock by subsidiaries.

(s) No optional prepayments on 1979 Debt unless ratable optional prepayments are made on this debt.

(t) No sales to or purchases from affiliates.

(u) Lease rental obligations (other than hydrocarbon leases, drilling rig leases and leases of office space) not to exceed 5% of debt permitted under (i)(i), (i)(ii), (i)(iii) and (i)(vii).

(v) As soon as feasible, Placid and PIOL to enter into new $450,000,000 agreement with amortization similar to the present 1979 Agreement and other terms (other than those relating to the Partnership and Hunt Brothers) similar to the credit agreement related to this debt.

(w) General Partner to engage in no business except as contemplated by the Partnership Agreement.

(x) Other usual and customary covenants.

Covenants (by Hunt Brothers under Guaranty): Restrictions on investment activities and liability creation similar to restrictions contemplated by the Partnership Commitment Letter and covenant not to become officers or directors of Placid.

Default: Usual and customary, including default if any of the Hunt Brothers shall become an officer or director of Placid.

Waiver and Amendments: Requires lenders holding 2/3 of debt ("Majority Banks").

Legal Expenses: Payable by Placid, whether or not credit agreement is executed, including fees and expenses of counsel for each Agent and special counsel for lenders.

Credit Agreement and Other Documentation: The commitment of the undersigned is subject to negotiation and execution of a credit agreement, a closing agreement and security documentation in form and substance satisfactory to lenders and their counsel.

Governing Law: New York.

If the foregoing is acceptable to you, please so indicate by executing and delivering a counterpart hereof so that comprehensive definitive documentation for this credit facility may be prepared. This agreement will terminate and expire unless the various conditions and requirements herein have been satisfied by Placid or waived by all lenders on or before 2:00 P.M., New York time, on May 31, 1980.

FIRST NATIONAL BANK IN DALLAS,
as Lender and as Agent

By: /s/

MORGAN GUARANTY TRUST COMPANY
OF NEW YORK, as Lender and
as Agent

By: /s/

CITIBANK, N.A.

By: /s/

THE CHASE MANHATTAN BANK
(NATIONAL ASSOCIATION)

By: /s/

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION

By: /s/

MANUFACTURERS HANOVER TRUST COMPANY

By: /s/

CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO

By: /s/

CANADIAN IMPERIAL BANK OF COMMERCE

By: /s/

THE ROYAL BANK OF CANADA

By: /s/

THE FIRST NATIONAL BANK OF CHICAGO

By: /s/

BANKERS TRUST COMPANY

By: /s/

CHEMICAL BANK

By: /s/

REPUBLIC NATIONAL BANK OF DALLAS

By: /s/

Accepted and agreed to:

PLACID OIL COMPANY

By: BH

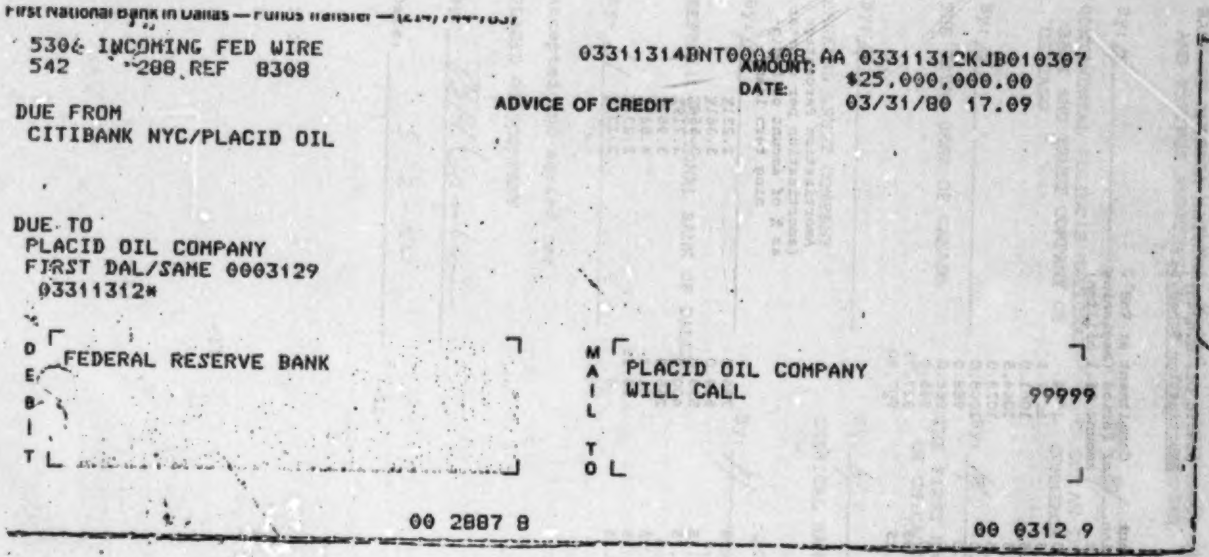
Date: 5-2-80

Placid Oil Company
Amortization Schedule

	Commitment Reduction Amount	Commitment at End of Period (beginning amount $1.1 billion)
Nov. 80	6.0	1094
Feb. 81	16.5	1077.5
May 81	16.5	1061.0
Aug. 81	16.5	1044.5
Nov. 81	16.5	1028.0
Feb. 82	20.0	1008.0
May 82	20.0	988.0
Aug. 82	20.0	968.0
Nov. 82	20.0	948.0
Feb. 83	20.25	927.75
May 83	20.25	907.50

Converts to term

				Amortization Percentage (amortization per quarter as % of amount of beginning term loan)
Q12-17	6q.	20.25	786.0	2.231%
18-21	4q.	30.5	664.0	3.361%
22-25	4q.	32.25	535.0	3.554%
26-29	4q.	33.75	400.0	3.719%
30-33	4q.	36.0	256.0	3.967%
34-37	4q.	43.75	81.0	4.821%
38-40	3q.	20.25	20.25	2.231%
final	1q.	20.25	0	2.231%



First National Bank in Dallas — Funds Transfer —

5306 INCOMING FED WIRE
542 288 REF 8308

03311314BNT000108 AA 03311312KJB010307

ADVICE OF CREDIT

AMOUNT: $25,000,000.00
DATE: 03/31/80 17.09

DUE FROM
CITIBANK NYC/PLACID OIL

DUE TO
PLACID OIL COMPANY
FIRST DAL/SAME 0003129
03311312*

DEBIT
FEDERAL RESERVE BANK

MAIL TO
PLACID OIL COMPANY
WILL CALL
99999

00 2887 8

00 0312 9

5532 INCOMING FED WIRE
542 288 REF 8406

04011435BNT100299 AA 04011438KJB010535
AMOUNT: $40,000,000.00
DATE: 04/01/80 17.04

ADVICE OF CREDIT

DUE FROM
CITIBANK NYC/PLACID OIL CO

DUE TO
PLACID OIL COMPANY
FIRST DAL/SAME 0003129
04011434*

CALLED SUSIE 15:25

DEBIT
FEDERAL RESERVE BANK

MAIL TO
PLACID OIL COMPANY
WILL CALL
99999

00 2887 8

00 0312 9

First National Bank in Dallas — Funds Transfer — [illegible]

0211 OUTGOING FED WIRE
542 200 REF 0211

ADVICE OF DEBIT

AMOUNT: $50,000,000.00
DATE: 04/03/80 10.51

04031151KJB160001 AA

DUE FROM
PLACID OIL COMPANY
FIRST DAL/PLACID OIL CO

DUE TO
CITIBANK NYC/FTR/ATTN PEGGY WILSON NABG LOAN DEPT 12TH FLR FOR LOAN PYMT PLACID OIL CO

MAIL TO
PLACID OIL COMPANY
WILL CALL
99999

00 0312 9

CREDIT
FEDERAL RESERVE BANK

00 2887 8

First National Bank in Dallas — Funds Transfer — (214) 744-7837

5340 INCOMING FED WIRE
542 288 REF 6695

04281340BK4066695 AA 04281341KJB010341

AMOUNT: $15,000,000.00
DATE 04/28/80 13.55

DUE FROM
MORGAN NYC/PLACID OIL COMPANY

ADVICE OF CREDIT

DUE TO
PLACID OIL COMPANY
FIRST DAL/CDT PLACID OIL CO GENERAL A/C#0003129
04281342*

NOTIFIED BY PHN BARBARA 13 22

DEBIT
FEDERAL RESERVE BANK

00 2887 8

MAIL TO
PLACID OIL COMPANY
WILL CALL

99999

00 0312 9

MORGAN GUARANTY TRUST COMPANY
OF NEW YORK
23 WALL STREET, NEW YORK, N.Y. 10015

New York April 25, 1980

Placid Oil Company
1600 First National Bank Building
Dallas, Texas 75202

Dear Sirs:

We hereby offer to Placid Oil Company a line of credit for $10 million for a period to June 30, 1980 to be used solely for its normal working capital needs, including payment of trade obligations, estimated taxes and interest.

Borrowings will be in the form of demand notes. Interest and fee in lieu of balances will be at the same rates as for the $300 million credit extended to Placid on April 8, 1980 with a 1/2% commitment fee on the unused portion of the facility. Payments will be made monthly commencing May 31, 1980.

Yours very truly,

Lucas P. Kellogg

Accepted by:

Max J Gardner
Placid Oil Company

$ 5,000,000.00

New York, N. Y., April 28 1980

On Demand after date, for value received, we promise to pay

to the order of MORGAN GUARANTY TRUST COMPANY OF NEW YORK

Five Million and 00/100 Dollars

at the Main office of **MORGAN GUARANTY TRUST COMPANY OF NEW YORK**

THIS NOTE AND THE LOAN EVIDENCED THEREBY SHALL BE GOVERNED BY THE LAWS OF NEW YORK.

PLACID OIL COMPANY

The Chase Manhattan Bank, N.A.
1 Chase Manhattan Plaza
New York, New York 10015

Grant A. Porter
Vice President

CHASE

April 25, 1980

Placid Oil Company
1600 First National
Bank Building
Dallas, Texas 75202

Dear Sirs:

We hereby offer to Placid Oil a line of credit for $10 million for a period to June 30, 1980 to be used solely for its normal working capital needs, including payment of trade obligations, estimated taxes and interest.

Borrowings will be in the form of demand notes. Interest and fee in lieu of balances will be at the same rates as for the $300 million credit extended to Placid on April 8, 1980 with a 1/2% commitment fee on the unused portion of the facility. Payments will be made monthly commencing on May 31, 1980.

Sincerely,

Accepted By:

Placid Oil Company

MANUFACTURERS HANOVER TRUST COMPANY

350 PARK AVENUE, NEW YORK, N.Y. 10022

April 28, 1980

Placid Oil Company
1600 First National Bank
  Building
Dallas, Texas 75202

Gentlemen:

Manufacturers Hanover is pleased to offer to Placid Oil Company a $10 million unsecured line of credit for a period to June 30, 1980. We understand that drawings under this line of credit will be used to fund the company's normal working capital requirements. Borrowings will be in the form of demand notes. Interest and a fee in lieu of balances will be at the same rate as for the $300 million credit extended to Placid on April 8, 1980 with a 1/2% commitment fee charged on the unused portion of the facility. Payments of interest and fees will be made monthly commencing May 31, 1980.

This credit facility is extended to the company subject to our continued satisfaction with the financial progress of Placid Oil Company. Please acknowledge acceptance of this facility by returning a signed copy of this letter to my attention.

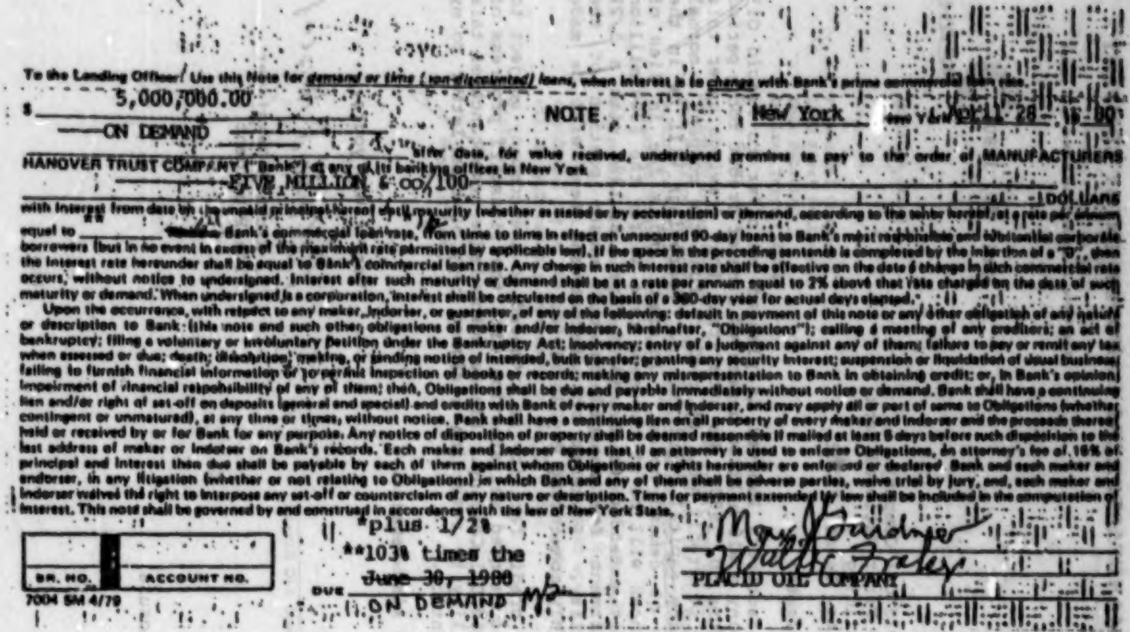
With kind regards.

Very truly yours,

P Richard Gessinger

P. Richard Gessinger
Vice President

Enclosure



To the Lending Officer: Use this Note for demand or time (non-discounted) loans, when interest is to change with Bank's prime commercial loan rate.

$ 5,000,000.00 NOTE New York April 28 19 80

—ON DEMAND— after date, for value received, undersigned promises to pay to the order of MANUFACTURERS HANOVER TRUST COMPANY ("Bank") at any of its banking offices in New York

—FIVE MILLION & 00/100— DOLLARS

with interest from date on the unpaid principal hereof until maturity (whether as stated or by acceleration) or demand, according to the tenor hereof, at a rate per annum equal to ** ~~% above~~ Bank's commercial loan rate, from time to time in effect on unsecured 90-day loans to Bank's most responsible and substantial corporate borrowers (but in no event in excess of the maximum rate permitted by applicable law). If the space in the preceding sentence is completed by the insertion of a "0", then the interest rate hereunder shall be equal to Bank's commercial loan rate. Any change in such interest rate shall be effective on the date a change in such commercial rate occurs, without notice to undersigned. Interest after such maturity or demand shall be at a rate per annum equal to 2% above that rate charged on the date of such maturity or demand. When undersigned is a corporation, interest shall be calculated on the basis of a 360-day year for actual days elapsed.*

Upon the occurrence, with respect to any maker, indorser, or guarantor, of any of the following: default in payment of this note or any other obligation of any nature or description to Bank (this note and such other obligations of maker and/or indorser, hereinafter, "Obligations"); calling a meeting of any creditors; an act of bankruptcy; filing a voluntary or involuntary petition under the Bankruptcy Act; insolvency; entry of a judgment against any of them; failure to pay or remit any tax when assessed or due; death; dissolution; making, or sending notice of intended, bulk transfer; granting any security interest; suspension or liquidation of usual business; failing to furnish financial information or to permit inspection of books or records; making any misrepresentation to Bank in obtaining credit; or, in Bank's opinion, impairment of financial responsibility of any of them; then, Obligations shall be due and payable immediately without notice or demand. Bank shall have a continuing lien and/or right of set-off on deposits (general and special) and credits with Bank of every maker and indorser, and may apply all or part of same to Obligations (whether contingent or unmatured), at any time or times, without notice. Bank shall have a continuing lien on all property of every maker and indorser and the proceeds thereof held or received by or for Bank for any purpose. Any notice of disposition of property shall be deemed reasonable if mailed at least 5 days before such disposition to the last address of maker or indorser on Bank's records. Each maker and indorser agrees that if an attorney is used to enforce Obligations, an attorney's fee of 15% of principal and interest then due shall be payable by each of them against whom Obligations or rights hereunder are enforced or declared. Bank and each maker and endorser, in any litigation (whether or not relating to Obligations) in which Bank and any of them shall be adverse parties, waive trial by jury, and, each maker and indorser waives the right to interpose any set-off or counterclaim of any nature or description. Time for payment extended by law shall be included in the computation of interest. This note shall be governed by and construed in accordance with the law of New York State.

*plus 1/2%

**103% times the

BR. NO.		ACCOUNT NO.

7004 SM 4/79

DUE ~~June 30, 1980~~ ON DEMAND MB

PLACID OIL COMPANY

INTERIM DEMAND NOTE

$56,250,000

New York, New York
April 8, 1980

FOR VALUE RECEIVED, Placid Oil Company, a Delaware corporation (the "Borrower"), hereby unconditionally promises to pay to the order of Citibank, N.A. (the "Bank") on demand the principal sum of $56,250,000 or the unpaid principal amount of loans by the Bank to the Borrower then outstanding under this Note, whichever is less. The Borrower shall pay interest on the aggregate unpaid principal amount of loans from time to time outstanding hereunder, payable on demand, at a rate per annum, calculated on the basis of actual days elapsed over a 360-day year, which shall from day to day be equal to 103% of the sum of (i) the Floating Base Rate (as such term is defined below) and (ii) 1/2%. Any overdue principal and, to the extent permitted by law, any overdue interest shall bear interest at a rate per annum equal to the sum of 2% and the otherwise applicable rate of interest. All such principal and interest shall be payable in lawful currency of the United States of America in immediately available funds at the office of Morgan Guaranty Trust Company of New York ("Morgan Guaranty"), 23 Wall Street, New York, New York 10015 for the account of the Bank.

The holder of this Note shall, and is hereby authorized by the Borrower to, endorse on the schedule forming a part hereof appropriate notations evidencing the date and amount of each loan made by the Bank under this Note and the date and amount of each payment of principal made by the Borrower with respect to such loans.

As used in this Note, the following terms shall have the following respective meanings:

> "Floating Base Rate" means the rate per annum at all times equal to the higher of the Prime Rate and the Adjusted CD Rate.
>
> "Prime Rate" means the rate of interest publicly announced by Morgan Guaranty in New York City from time to time as its Prime Rate, such rate to be adjusted automatically on and as of the effective date of any change in the Prime Rate.

"Adjusted CD Rate" means the product of (i) the Average Weekly 90-Day Secondary CD Rate times (ii) a fraction of which the numerator is 100% and the denominator is 100% minus the aggregate rates of (A) basic and supplemental reserve requirements in effect on the day of determination under Regulation D applicable to certificates of deposit in units of $100,000 or more issued by a "member bank" located in a "reserve city" (as such terms are used in Regulation D) and (B) marginal reserve requirements in effect on such date of determination under Regulation D applicable to time deposits of a "member bank".

"Average Weekly 90-Day Secondary CD Rate" means the 90-day secondary certificate of deposit ("CD") rate for the most recent weekly period covered therein in the Federal Reserve statistical release entitled "Weekly Summary of Banking and Credit Measures (Averages of daily figures)" which was released in the week preceding the week for which the CD rate is being determined. The CD rate so reported shall be in effect, for the purpose of this definition, for each day of the week commencing the Monday following the release date of such publication. If such publication or a substitute containing the foregoing rate information is not published by the Federal Reserve for any week, such average rate shall be determined by Morgan Guaranty on the basis of quotations received by it from three New York commercial paper dealers of recognized standing.

"Regulation D" shall mean Regulation D of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

If this Note is placed in the hands of an attorney for collection, or if it is collected through any legal proceedings, the Borrower agrees to pay reasonable attorneys' fees and other costs of collection, including, but not limited to, court costs, of the holder hereof.

Nothing in this Note shall require the Borrower to pay interest at a rate in excess of that permitted by the New York Penal Law to any holder to whom such law may be applicable.

This Note shall be construed in accordance with and governed by the law of the State of New York and the Federal law of the United States of America.

PLACID OIL COMPANY

By__________________________

SCHEDULE TO INTERIM DEMAND NOTE

Date	Amount of Loan	Principal Amount Repaid	Unpaid Principal Balance	Notation Made by

INTERIM DEMAND NOTE

$3,750,000

New York, New York
April 8, 1980

FOR VALUE RECEIVED, Placid Oil Company, a Delaware corporation (the "Borrower"), hereby unconditionally promises to pay to the order of First National Bank in Dallas (the "Bank") on demand the principal sum of $3,750,000 or the unpaid principal amount of loans by the Bank to the Borrower then outstanding under this Note, whichever is less. The Borrower shall pay interest on the aggregate unpaid principal amount of loans from time to time outstanding hereunder, payable on demand, at a rate per annum, calculated on the basis of actual days elapsed over a 360-day year, which shall from day to day be equal to 103% of the sum of (i) the Floating Base Rate (as such term is defined below) and (ii) 1/2%. Any overdue principal and, to the extent permitted by law, any overdue interest shall bear interest at a rate per annum equal to the sum of 2% and the otherwise applicable rate of interest. All such principal and interest shall be payable in lawful currency of the United States of America in immediately available funds at the office of Morgan Guaranty Trust Company of New York ("Morgan Guaranty"), 23 Wall Street, New York, New York 10015 for the account of the Bank.

The holder of this Note shall, and is hereby authorized by the Borrower to, endorse on the schedule forming a part hereof appropriate notations evidencing the date and amount of each loan made by the Bank under this Note and the date and amount of each payment of principal made by the Borrower with respect to such loans.

As used in this Note, the following terms shall have the following respective meanings:

"Floating Base Rate" means the rate per annum at all times equal to the higher of the Prime Rate and the Adjusted CD Rate.

"Prime Rate" means the rate of interest publicly announced by Morgan Guaranty in New York City from time to time as its Prime Rate, such rate to be adjusted automatically on and as of the effective date of any change in the Prime Rate.

"Adjusted CD Rate" means the product of (i) the Average Weekly 90-Day Secondary CD Rate times (ii) a fraction of which the numerator is 100% and the denominator is 100% minus the aggregate rates of (A) basic and supplemental reserve requirements in effect on the day of determination under Regulation D applicable to certificates of deposit in units of $100,000 or more issued by a "member bank" located in a "reserve city" (as such terms are used in Regulation D) and (B) marginal reserve requirements in effect on such date of determination under Regulation D applicable to time deposits of a "member bank".

"Average Weekly 90-Day Secondary CD Rate" means the 90-day secondary certificate of deposit ("CD") rate for the most recent weekly period covered therein in the Federal Reserve statistical release entitled "Weekly Summary of Banking and Credit Measures (Averages of daily figures)" which was released in the week preceding the week for which the CD rate is being determined. The CD rate so reported shall be in effect, for the purpose of this definition, for each day of the week commencing the Monday following the release date of such publication. If such publication or a substitute containing the foregoing rate information is not published by the Federal Reserve for any week, such average rate shall be determined by Morgan Guaranty on the basis of quotations received by it from three New York commercial paper dealers of recognized standing.

"Regulation D" shall mean Regulation D of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

If this Note is placed in the hands of an attorney for collection, or if it is collected through any legal proceedings, the Borrower agrees to pay reasonable attorneys' fees and other costs of collection, including, but not limited to, court costs, of the holder hereof.

Nothing in this Note shall require the Borrower to pay interest at a rate in excess of that permitted by the New York Penal Law to any holder to whom such law may be applicable.

This Note shall be construed in accordance with and governed by the law of the State of New York and the Federal law of the United States of America.

PLACID OIL COMPANY

By__________________________

SCHEDULE TO INTERIM DEMAND NOTE

Date	Amount of Loan	Principal Amount Repaid	Unpaid Principal Balance	Notation Made by

INTERIM DEMAND NOTE

$18,750,000

New York, New York
April 8, 1980

FOR VALUE RECEIVED, Placid Oil Company, a Delaware corporation (the "Borrower"), hereby unconditionally promises to pay to the order of Chemical Bank (the "Bank") on demand the principal sum of $18,750,000 or the unpaid principal amount of loans by the Bank to the Borrower then outstanding under this Note, whichever is less. The Borrower shall pay interest on the aggregate unpaid principal amount of loans from time to time outstanding hereunder, payable on demand, at a rate per annum, calculated on the basis of actual days elapsed over a 360-day year, which shall from day to day be equal to 103% of the sum of (i) the Floating Base Rate (as such term is defined below) and (ii) 1/2%. Any overdue principal and, to the extent permitted by law, any overdue interest shall bear interest at a rate per annum equal to the sum of 2% and the otherwise applicable rate of interest. All such principal and interest shall be payable in lawful currency of the United States of America in immediately available funds at the office of Morgan Guaranty Trust Company of New York ("Morgan Guaranty"), 23 Wall Street, New York, New York 10015 for the account of the Bank.

The holder of this Note shall, and is hereby authorized by the Borrower to, endorse on the schedule forming a part hereof appropriate notations evidencing the date and amount of each loan made by the Bank under this Note and the date and amount of each payment of principal made by the Borrower with respect to such loans.

As used in this Note, the following terms shall have the following respective meanings:

"Floating Base Rate" means the rate per annum at all times equal to the higher of the Prime Rate and the Adjusted CD Rate.

"Prime Rate" means the rate of interest publicly announced by Morgan Guaranty in New York City from time to time as its Prime Rate, such rate to be adjusted automatically on and as of the effective date of any change in the Prime Rate.

"Adjusted CD Rate" means the product of (i) the Average Weekly 90-Day Secondary CD Rate times (ii) a fraction of which the numerator is 100% and the denominator is 100% minus the aggregate rates of (A) basic and supplemental reserve requirements in effect on the day of determination under Regulation D applicable to certificates of deposit in units of $100,000 or more issued by a "member bank" located in a "reserve city" (as such terms are used in Regulation D) and (B) marginal reserve requirements in effect on such date of determination under Regulation D applicable to time deposits of a "member bank".

"Average Weekly 90-Day Secondary CD Rate" means the 90-day secondary certificate of deposit ("CD") rate for the most recent weekly period covered therein in the Federal Reserve statistical release entitled "Weekly Summary of Banking and Credit Measures (Averages of daily figures)" which was released in the week preceding the week for which the CD rate is being determined. The CD rate so reported shall be in effect, for the purpose of this definition, for each day of the week commencing the Monday following the release date of such publication. If such publication or a substitute containing the foregoing rate information is not published by the Federal Reserve for any week, such average rate shall be determined by Morgan Guaranty on the basis of quotations received by it from three New York commercial paper dealers of recognized standing.

"Regulation D" shall mean Regulation D of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

If this Note is placed in the hands of an attorney for collection, or if it is collected through any legal proceedings, the Borrower agrees to pay reasonable attorneys' fees and other costs of collection, including, but not limited to, court costs, of the holder hereof.

Nothing in this Note shall require the Borrower to pay interest at a rate in excess of that permitted by the New York Penal Law to any holder to whom such law may be applicable.

This Note shall be construed in accordance with and governed by the law of the State of New York and the Federal law of the United States of America.

PLACID OIL COMPANY

By__________________________

SCHEDULE TO INTERIM DEMAND NOTE

Date	Amount of Loan	Principal Amount Repaid	Unpaid Principal Balance	Notation Made by

INTERIM DEMAND NOTE

$37,500,000

New York, New York
April 8, 1980

FOR VALUE RECEIVED, Placid Oil Company, a Delaware corporation (the "Borrower"), hereby unconditionally promises to pay to the order of Bank of America National Trust and Savings Association (the "Bank") on demand the principal sum of $37,500,000 or the unpaid principal amount of loans by the Bank to the Borrower then outstanding under this Note, whichever is less. The Borrower shall pay interest on the aggregate unpaid principal amount of loans from time to time outstanding hereunder, payable on demand, at a rate per annum, calculated on the basis of actual days elapsed over a 360-day year, which shall from day to day be equal to 103% of the sum of (i) the Floating Base Rate (as such term is defined below) and (ii) 1/2%. Any overdue principal and, to the extent permitted by law, any overdue interest shall bear interest at a rate per annum equal to the sum of 2% and the otherwise applicable rate of interest. All such principal and interest shall be payable in lawful currency of the United States of America in immediately available funds at the office of Morgan Guaranty Trust Company of New York ("Morgan Guaranty"), 23 Wall Street, New York, New York 10015 for the account of the Bank.

The holder of this Note shall, and is hereby authorized by the Borrower to, endorse on the schedule forming a part hereof appropriate notations evidencing the date and amount of each loan made by the Bank under this Note and the date and amount of each payment of principal made by the Borrower with respect to such loans.

As used in this Note, the following terms shall have the following respective meanings:

> "Floating Base Rate" means the rate per annum at all times equal to the higher of the Prime Rate and the Adjusted CD Rate.
>
> "Prime Rate" means the rate of interest publicly announced by Morgan Guaranty in New York City from time to time as its Prime Rate, such rate to be adjusted automatically on and as of the effective date of any change in the Prime Rate.

"Adjusted CD Rate" means the product of (i) the Average Weekly 90-Day Secondary CD Rate times (ii) a fraction of which the numerator is 100% and the denominator is 100% minus the aggregate rates of (A) basic and supplemental reserve requirements in effect on the day of determination under Regulation D applicable to certificates of deposit in units of $100,000 or more issued by a "member bank" located in a "reserve city" (as such terms are used in Regulation D) and (B) marginal reserve requirements in effect on such date of determination under Regulation D applicable to time deposits of a "member bank".

"Average Weekly 90-Day Secondary CD Rate" means the 90-day secondary certificate of deposit ("CD") rate for the most recent weekly period covered therein in the Federal Reserve statistical release entitled "Weekly Summary of Banking and Credit Measures (Averages of daily figures)" which was released in the week preceding the week for which the CD rate is being determined. The CD rate so reported shall be in effect, for the purpose of this definition, for each day of the week commencing the Monday following the release date of such publication. If such publication or a substitute containing the foregoing rate information is not published by the Federal Reserve for any week, such average rate shall be determined by Morgan Guaranty on the basis of quotations received by it from three New York commercial paper dealers of recognized standing.

"Regulation D" shall mean Regulation D of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

If this Note is placed in the hands of an attorney for collection, or if it is collected through any legal proceedings, the Borrower agrees to pay reasonable attorneys' fees and other costs of collection, including, but not limited to, court costs, of the holder hereof.

Nothing in this Note shall require the Borrower to pay interest at a rate in excess of that permitted by the New York Penal Law to any holder to whom such law may be applicable.

This Note shall be construed in accordance with and governed by the law of the State of New York and the Federal law of the United States of America.

PLACID OIL COMPANY

By______________________________

SCHEDULE TO INTERIM DEMAND NOTE

Date	Amount of Loan	Principal Amount Repaid	Unpaid Principal Balance	Notation Made by

INTERIM DEMAND NOTE

$26,250,000

New York, New York
April 8, 1980

FOR VALUE RECEIVED, Placid Oil Company, a Delaware corporation (the "Borrower"), hereby unconditionally promises to pay to the order of Continental Illinois National Bank and Trust Company of Chicago (the "Bank") on demand the principal sum of $26,250,000 or the unpaid principal amount of loans by the Bank to the Borrower then outstanding under this Note, whichever is less. The Borrower shall pay interest on the aggregate unpaid principal amount of loans from time to time outstanding hereunder, payable on demand, at a rate per annum, calculated on the basis of actual days elapsed over a 360-day year, which shall from day to day be equal to 103% of the sum of (i) the Floating Base Rate (as such term is defined below) and (ii) 1/2%. Any overdue principal and, to the extent permitted by law, any overdue interest shall bear interest at a rate per annum equal to the sum of 2% and the otherwise applicable rate of interest. All such principal and interest shall be payable in lawful currency of the United States of America in immediately available funds at the office of Morgan Guaranty Trust Company of New York ("Morgan Guaranty"), 23 Wall Street, New York, New York 10015 for the account of the Bank.

The holder of this Note shall, and is hereby authorized by the Borrower to, endorse on the schedule forming a part hereof appropriate notations evidencing the date and amount of each loan made by the Bank under this Note and the date and amount of each payment of principal made by the Borrower with respect to such loans.

As used in this Note, the following terms shall have the following respective meanings:

"Floating Base Rate" means the rate per annum at all times equal to the higher of the Prime Rate and the Adjusted CD Rate.

"Prime Rate" means the rate of interest publicly announced by Morgan Guaranty in New York City from time to time as its Prime Rate, such rate to be adjusted automatically on and as of the effective date of any change in the Prime Rate.

"Adjusted CD Rate" means the product of (i) the Average Weekly 90-Day Secondary CD Rate times (ii) a fraction of which the numerator is 100% and the denominator is 100% minus the aggregate rates of (A) basic and supplemental reserve requirements in effect on the day of determination under Regulation D applicable to certificates of deposit in units of $100,000 or more issued by a "member bank" located in a "reserve city" (as such terms are used in Regulation D) and (B) marginal reserve requirements in effect on such date of determination under Regulation D applicable to time deposits of a "member bank".

"Average Weekly 90-Day Secondary CD Rate" means the 90-day secondary certificate of deposit ("CD") rate for the most recent weekly period covered therein in the Federal Reserve statistical release entitled "Weekly Summary of Banking and Credit Measures (Averages of daily figures)" which was released in the week preceding the week for which the CD rate is being determined. The CD rate so reported shall be in effect, for the purpose of this definition, for each day of the week commencing the Monday following the release date of such publication. If such publication or a substitute containing the foregoing rate information is not published by the Federal Reserve for any week, such average rate shall be determined by Morgan Guaranty on the basis of quotations received by it from three New York commercial paper dealers of recognized standing.

"Regulation D" shall mean Regulation D of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

If this Note is placed in the hands of an attorney for collection, or if it is collected through any legal proceedings, the Borrower agrees to pay reasonable attorneys' fees and other costs of collection, including, but not limited to, court costs, of the holder hereof.

Nothing in this Note shall require the Borrower to pay interest at a rate in excess of that permitted by the New York Penal Law to any holder to whom such law may be applicable.

This Note shall be construed in accordance with and governed by the law of the State of New York and the Federal law of the United States of America.

PLACID OIL COMPANY

By___________________________

SCHEDULE TO INTERIM DEMAND NOTE

Date	Amount of Loan	Principal Amount Repaid	Unpaid Principal Balance	Notation Made by

INTERIM DEMAND NOTE

$26,250,000

New York, New York
April 8, 1980

FOR VALUE RECEIVED, Placid Oil Company, a Delaware corporation (the "Borrower"), hereby unconditionally promises to pay to the order of The First National Bank of Chicago (the "Bank") on demand the principal sum of $26,250,000 or the unpaid principal amount of loans by the Bank to the Borrower then outstanding under this Note, whichever is less. The Borrower shall pay interest on the aggregate unpaid principal amount of loans from time to time outstanding hereunder, payable on demand, at a rate per annum, calculated on the basis of actual days elapsed over a 360-day year, which shall from day to day be equal to 103% of the sum of (i) the Floating Base Rate (as such term is defined below) and (ii) 1/2%. Any overdue principal and, to the extent permitted by law, any overdue interest shall bear interest at a rate per annum equal to the sum of 2% and the otherwise applicable rate of interest. All such principal and interest shall be payable in lawful currency of the United States of America in immediately available funds at the office of Morgan Guaranty Trust Company of New York ("Morgan Guaranty"), 23 Wall Street, New York, New York 10015 for the account of the Bank.

The holder of this Note shall, and is hereby authorized by the Borrower to, endorse on the schedule forming a part hereof appropriate notations evidencing the date and amount of each loan made by the Bank under this Note and the date and amount of each payment of principal made by the Borrower with respect to such loans.

As used in this Note, the following terms shall have the following respective meanings:

"Floating Base Rate" means the rate per annum at all times equal to the higher of the Prime Rate and the Adjusted CD Rate.

"Prime Rate" means the rate of interest publicly announced by Morgan Guaranty in New York City from time to time as its Prime Rate, such rate to be adjusted automatically on and as of the effective date of any change in the Prime Rate.

"Adjusted CD Rate" means the product of (i) the Average Weekly 90-Day Secondary CD Rate times (ii) a fraction of which the numerator is 100% and the denominator is 100% minus the aggregate rates of (A) basic and supplemental reserve requirements in effect on the day of determination under Regulation D applicable to certificates of deposit in units of $100,000 or more issued by a "member bank" located in a "reserve city" (as such terms are used in Regulation D) and (B) marginal reserve requirements in effect on such date of determination under Regulation D applicable to time deposits of a "member bank".

"Average Weekly 90-Day Secondary CD Rate" means the 90-day secondary certificate of deposit ("CD") rate for the most recent weekly period covered therein in the Federal Reserve statistical release entitled "Weekly Summary of Banking and Credit Measures (Averages of daily figures)" which was released in the week preceding the week for which the CD rate is being determined. The CD rate so reported shall be in effect, for the purpose of this definition, for each day of the week commencing the Monday following the release date of such publication. If such publication or a substitute containing the foregoing rate information is not published by the Federal Reserve for any week, such average rate shall be determined by Morgan Guaranty on the basis of quotations received by it from three New York commercial paper dealers of recognized standing.

"Regulation D" shall mean Regulation D of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

If this Note is placed in the hands of an attorney for collection, or if it is collected through any legal proceedings, the Borrower agrees to pay reasonable attorneys' fees and other costs of collection, including, but not limited to, court costs, of the holder hereof.

Nothing in this Note shall require the Borrower to pay interest at a rate in excess of that permitted by the New York Penal Law to any holder to whom such law may be applicable.

This Note shall be construed in accordance with and governed by the law of the State of New York and the Federal law of the United States of America.

PLACID OIL COMPANY

By________________________

SCHEDULE TO INTERIM DEMAND NOTE

Date	Amount of Loan	Principal Amount Repaid	Unpaid Principal Balance	Notation Made by

INTERIM DEMAND NOTE

$37,500,000

New York, New York
April 8, 1980

FOR VALUE RECEIVED, Placid Oil Company, a Delaware corporation (the "Borrower"), hereby unconditionally promises to pay to the order of Manufacturers Hanover Trust Company (the "Bank") on demand the principal sum of $37,500,000 or the unpaid principal amount of loans by the Bank to the Borrower then outstanding under this Note, whichever is less. The Borrower shall pay interest on the aggregate unpaid principal amount of loans from time to time outstanding hereunder, payable on demand, at a rate per annum, calculated on the basis of actual days elapsed over a 360-day year, which shall from day to day be equal to 103% of the sum of (i) the Floating Base Rate (as such term is defined below) and (ii) 1/2%. Any overdue principal and, to the extent permitted by law, any overdue interest shall bear interest at a rate per annum equal to the sum of 2% and the otherwise applicable rate of interest. All such principal and interest shall be payable in lawful currency of the United States of America in immediately available funds at the office of Morgan Guaranty Trust Company of New York ("Morgan Guaranty"), 23 Wall Street, New York, New York 10015 for the account of the Bank.

The holder of this Note shall, and is hereby authorized by the Borrower to, endorse on the schedule forming a part hereof appropriate notations evidencing the date and amount of each loan made by the Bank under this Note and the date and amount of each payment of principal made by the Borrower with respect to such loans.

As used in this Note, the following terms shall have the following respective meanings:

"Floating Base Rate" means the rate per annum at all times equal to the higher of the Prime Rate and the Adjusted CD Rate.

"Prime Rate" means the rate of interest publicly announced by Morgan Guaranty in New York City from time to time as its Prime Rate, such rate to be adjusted automatically on and as of the effective date of any change in the Prime Rate.

"Adjusted CD Rate" means the product of (i) the Average Weekly 90-Day Secondary CD Rate times (ii) a fraction of which the numerator is 100% and the denominator is 100% minus the aggregate rates of (A) basic and supplemental reserve requirements in effect on the day of determination under Regulation D applicable to certificates of deposit in units of $100,000 or more issued by a "member bank" located in a "reserve city" (as such terms are used in Regulation D) and (B) marginal reserve requirements in effect on such date of determination under Regulation D applicable to time deposits of a "member bank".

"Average Weekly 90-Day Secondary CD Rate" means the 90-day secondary certificate of deposit ("CD") rate for the most recent weekly period covered therein in the Federal Reserve statistical release entitled "Weekly Summary of Banking and Credit Measures (Averages of daily figures)" which was released in the week preceding the week for which the CD rate is being determined. The CD rate so reported shall be in effect, for the purpose of this definition, for each day of the week commencing the Monday following the release date of such publication. If such publication or a substitute containing the foregoing rate information is not published by the Federal Reserve for any week, such average rate shall be determined by Morgan Guaranty on the basis of quotations received by it from three New York commercial paper dealers of recognized standing.

"Regulation D" shall mean Regulation D of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

If this Note is placed in the hands of an attorney for collection, or if it is collected through any legal proceedings, the Borrower agrees to pay reasonable attorneys' fees and other costs of collection, including, but not limited to, court costs, of the holder hereof.

Nothing in this Note shall require the Borrower to pay interest at a rate in excess of that permitted by the New York Penal Law to any holder to whom such law may be applicable.

This Note shall be construed in accordance with and governed by the law of the State of New York and the Federal law of the United States of America.

PLACID OIL COMPANY

By_________________________

SCHEDULE TO INTERIM DEMAND NOTE

Date	Amount of Loan	Principal Amount Repaid	Unpaid Principal Balance	Notation Made by

INTERIM DEMAND NOTE

$56,250,000

New York, New York
April 8, 1980

FOR VALUE RECEIVED, Placid Oil Company, a Delaware corporation (the "Borrower"), hereby unconditionally promises to pay to the order of The Chase Manhattan Bank (National Association) (the "Bank") on demand the principal sum of $56,250,000 or the unpaid principal amount of loans by the Bank to the Borrower then outstanding under this Note, whichever is less. The Borrower shall pay interest on the aggregate unpaid principal amount of loans from time to time outstanding hereunder, payable on demand, at a rate per annum, calculated on the basis of actual days elapsed over a 360-day year, which shall from day to day be equal to 103% of the sum of (i) the Floating Base Rate (as such term is defined below) and (ii) 1/2%. Any overdue principal and, to the extent permitted by law, any overdue interest shall bear interest at a rate per annum equal to the sum of 2% and the otherwise applicable rate of interest. All such principal and interest shall be payable in lawful currency of the United States of America in immediately available funds at the office of Morgan Guaranty Trust Company of New York ("Morgan Guaranty"), 23 Wall Street, New York, New York 10015 for the account of the Bank.

The holder of this Note shall, and is hereby authorized by the Borrower to, endorse on the schedule forming a part hereof appropriate notations evidencing the date and amount of each loan made by the Bank under this Note and the date and amount of each payment of principal made by the Borrower with respect to such loans.

As used in this Note, the following terms shall have the following respective meanings:

"Floating Base Rate" means the rate per annum at all times equal to the higher of the Prime Rate and the Adjusted CD Rate.

"Prime Rate" means the rate of interest publicly announced by Morgan Guaranty in New York City from time to time as its Prime Rate, such rate to be adjusted automatically on and as of the effective date of any change in the Prime Rate.

"Adjusted CD Rate" means the product of (i) the Average Weekly 90-Day Secondary CD Rate times (ii) a fraction of which the numerator is 100% and the denominator is 100% minus the aggregate rates of (A) basic and supplemental reserve requirements in effect on the day of determination under Regulation D applicable to certificates of deposit in units of $100,000 or more issued by a "member bank" located in a "reserve city" (as such terms are used in Regulation D) and (B) marginal reserve requirements in effect on such date of determination under Regulation D applicable to time deposits of a "member bank".

"Average Weekly 90-Day Secondary CD Rate" means the 90-day secondary certificate of deposit ("CD") rate for the most recent weekly period covered therein in the Federal Reserve statistical release entitled "Weekly Summary of Banking and Credit Measures (Averages of daily figures)" which was released in the week preceding the week for which the CD rate is being determined. The CD rate so reported shall be in effect, for the purpose of this definition, for each day of the week commencing the Monday following the release date of such publication. If such publication or a substitute containing the foregoing rate information is not published by the Federal Reserve for any week, such average rate shall be determined by Morgan Guaranty on the basis of quotations received by it from three New York commercial paper dealers of recognized standing.

"Regulation D" shall mean Regulation D of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

If this Note is placed in the hands of an attorney for collection, or if it is collected through any legal proceedings, the Borrower agrees to pay reasonable attorneys' fees and other costs of collection, including, but not limited to, court costs, of the holder hereof.

Nothing in this Note shall require the Borrower to pay interest at a rate in excess of that permitted by the New York Penal Law to any holder to whom such law may be applicable.

This Note shall be construed in accordance with and governed by the law of the State of New York and the Federal law of the United States of America.

PLACID OIL COMPANY

By____________________________

SCHEDULE TO INTERIM DEMAND NOTE

Date	Amount of Loan	Principal Amount Repaid	Unpaid Principal Balance	Notation Made by

INTERIM DEMAND NOTE

New York, New York
$37,500,000 April 8, 1980

FOR VALUE RECEIVED, Placid Oil Company, a Delaware corporation (the "Borrower"), hereby unconditionally promises to pay to the order of Morgan Guaranty Trust Company of New York (the "Bank") on demand the principal sum of $37,500,000 or the unpaid principal amount of loans by the Bank to the Borrower then outstanding under this Note, whichever is less. The Borrower shall pay interest on the aggregate unpaid principal amount of loans from time to time outstanding hereunder, payable on demand, at a rate per annum, calculated on the basis of actual days elapsed over a 360-day year, which shall from day to day be equal to 103% of the sum of (i) the Floating Base Rate (as such term is defined below) and (ii) 1/2%. Any overdue principal and, to the extent permitted by law, any overdue interest shall bear interest at a rate per annum equal to the sum of 2% and the otherwise applicable rate of interest. All such principal and interest shall be payable in lawful currency of the United States of America in immediately available funds at the office of Morgan Guaranty Trust Company of New York ("Morgan Guaranty"), 23 Wall Street, New York, New York 10015 for the account of the Bank.

The holder of this Note shall, and is hereby authorized by the Borrower to, endorse on the schedule forming a part hereof appropriate notations evidencing the date and amount of each loan made by the Bank under this Note and the date and amount of each payment of principal made by the Borrower with respect to such loans.

As used in this Note, the following terms shall have the following respective meanings:

"Floating Base Rate" means the rate per annum at all times equal to the higher of the Prime Rate and the Adjusted CD Rate.

"Prime Rate" means the rate of interest publicly announced by Morgan Guaranty in New York City from time to time as its Prime Rate, such rate to be adjusted automatically on and as of the effective date of any change in the Prime Rate.

"Adjusted CD Rate" means the product of (i) the Average Weekly 90-Day Secondary CD Rate times (ii) a fraction of which the numerator is 100% and the denominator is 100% minus the aggregate rates of (A) basic and supplemental reserve requirements in effect on the day of determination under Regulation D applicable to certificates of deposit in units of $100,000 or more issued by a "member bank" located in a "reserve city" (as such terms are used in Regulation D) and (B) marginal reserve requirements in effect on such date of determination under Regulation D applicable to time deposits of a "member bank".

"Average Weekly 90-Day Secondary CD Rate" means the 90-day secondary certificate of deposit ("CD") rate for the most recent weekly period covered therein in the Federal Reserve statistical release entitled "Weekly Summary of Banking and Credit Measures (Averages of daily figures)" which was released in the week preceding the week for which the CD rate is being determined. The CD rate so reported shall be in effect, for the purpose of this definition, for each day of the week commencing the Monday following the release date of such publication. If such publication or a substitute containing the foregoing rate information is not published by the Federal Reserve for any week, such average rate shall be determined by Morgan Guaranty on the basis of quotations received by it from three New York commercial paper dealers of recognized standing.

"Regulation D" shall mean Regulation D of the Board of Governors of the Federal Reserve System from time to time in effect and shall include any successor or other regulation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

If this Note is placed in the hands of an attorney for collection, or if it is collected through any legal proceedings, the Borrower agrees to pay reasonable attorneys' fees and other costs of collection, including, but not limited to, court costs, of the holder hereof.

Nothing in this Note shall require the Borrower to pay interest at a rate in excess of that permitted by the New York Penal Law to any holder to whom such law may be applicable.

This Note shall be construed in accordance with and governed by the law of the State of New York and the Federal law of the United States of America.

PLACID OIL COMPANY

By_________________________

SCHEDULE TO INTERIM DEMAND NOTE

Date	Amount of Loan	Principal Amount Repaid	Unpaid Principal Balance	Notation Made by

APPENDIX 5.—COMMODITY TAX STRADDLES

A. H.R. 7541, TO AMEND THE INTERNAL REVENUE CODE, SPONSORED BY REPRESENTATIVE VANIK AND REPRESENTATIVE ROSENTHAL

I

96TH CONGRESS
2D SESSION

H. R. 7541

To amend the Internal Revenue Code of 1954 with respect to offsetting positions in personal property.

IN THE HOUSE OF REPRESENTATIVES

JUNE 10, 1980

Mr. VANIK (for himself and Mr. ROSENTHAL) introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To amend the Internal Revenue Code of 1954 with respect to offsetting positions in personal property.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) part VII of subchapter O of chapter 1 of the Internal Revenue Code of 1954 (relating to wash sales of stock or securities) is amended by adding at the end thereof the following new section:

"SEC. 1092. OFFSETTING POSITIONS IN PERSONAL PROPERTY

"(a) GENERAL RULE.—In the case of offsetting positions in personal property—

"(1) that portion of the loss which exceeds recognized gain shall be treated as sustained not earlier than the close of the balanced period, and

"(2) the running of the holding periods for such positions (determined under section 1223) shall be suspended for the balanced period.

"(b) OFFSETTING POSITIONS.—

"(1) IN GENERAL.—For purposes of this section, the term 'offsetting positions' means that there is a substantial diminution of the taxpayer's risk of loss from holding any position with respect to personal property by reason of his holding 1 or more other positions with respect to personal property (whether or not of the same kind).

"(2) PRESUMPTION.—

"(A) IN GENERAL.—For purposes of paragraph (1), 2 or more positions shall be presumed to be offsetting if—

"(i) the positions are customarily treated as straddles or other offsetting positions,

"(ii) the aggregate margin requirement for such positions is lower than the sum of the margin requirements for each such position (if held separately), or "(iii) there are such other factors as the Secretary may by regulations prescribe as indicating that such positions are offsetting.

"(B) PRESUMPTION MAY BE REBUTTED.—Any presumption established pursuant to subparagraph (A) may be rebutted if the taxpayer establishes to the satisfaction of the Secretary that the positions were not offsetting.

"(3) HEDGING TRANSACTIONS.—The term 'offsetting positions' does not include positions in commodities which are an integral part of the taxpayer's business.

"(c) BALANCED PERIOD.—For purposes of this section, the term 'balanced period' means any period during which the taxpayer holds offsetting positions plus the 30-day period after the day on which such positions (or successor positions) cease to be offsetting.

"(d) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) PERSONAL PROPERTY.—The term 'personal property' means—

"(A) commodities,

"(B) evidences of indebtedness, and

"(C) any other type of personal property (other than stock in a corporation).

"(2) POSITION.—The term 'position' means an interest (including a futures contract or option). Personal property acquired by the taxpayer pursuant to a futures contract, option, or other interest shall be treated as the same position as such interest.

"(3) ATTRIBUTION.—In determining whether any positions are offsetting, the principles of section 318 shall apply, except that—

"(A) the members of an individual's family shall consist only of such individual, such individual's spouse, and a child of such individual who has not attained the age of 18, and

"(B) there is attribution to and from a corporation, partnership, trust, or estate only if—

"(i) there is at least an 80-percent interest (determined after the application of the family attribution rules), or

"(ii) in the case of a trust, the trust is a trust to which subpart E of part I of subchapter J applies."

(b) Section 1221 of such Code (defining capital asset) is amended by striking out paragraph (5) and by redesignating paragraph (6) as paragraph (5).

(c) The table of sections for such part VII is amended by adding at the end thereof the following new item:

"Sec. 1092. Offsetting positions in personal property."

(d)(1) The heading for such part VII is amended to read: "PART VII—WASH SALES; OFFSETTING POSITIONS".

(2) The table of parts for subchapter O of chapter 1 of such Code is amended by striking out the item relating to part VII and inserting in lieu thereof:

"Part VII. Wash sales; offsetting positions."

(e)(1) Except as provided in paragraph (2), the amendments made by this Act shall apply to offsetting positions established after June 30, 1980, in taxable years ending after such date.

(2) The amendments made by subsection (b) shall apply to obligations issued after December 31, 1980.

○

[illegible]

Congress of the United States
House of Representatives
Washington, D.C.

[illegible]

July 30, 1980

Dear Colleague:

Several weeks ago, I introduced legislation, H.R. 7541, with Congressman Benjamin Rosenthal (D-New York), to end a serious and growing abuse which threatens to undermine our voluntary system of taxation. This loophole, the so-called "tax straddle", is being used by thousands of the highest income individuals in the country. If allowed to continue, this tax device soon would cost the Treasury more than $3 billion a year--a revenue loss which middle and lower income taxpayers would have to make up. The tax dollars spent on these shelters contribute nothing to our economy, but are transformed into commissions for brokers and alleged tax reductions for their clients.

Commodity trading in this country now is a $2 trillion industry. The growth of tax straddle trades in this area has been enormous. The brokerage industry has spawned an entire subculture of tax straddle departments within the major brokerage houses.

Sophisticated and unscrupulous promoters are marketing a number of tax shelter schemes involving so-called "straddle" transactions. These activities are motivated solely by tax considerations and offer no opportunity for meaningful economic reward. They have attracted high-income clients eager to reduce or eliminate their income tax liabilities by deducting enormous paper losses from their incomes one year while deferring their offsetting gains to a later year. Some try not only to defer their taxes, they also try to convert ordinary income or short-term capital gain to long-term capital gain which is taxed at significantly lower rates.

Tax straddle promoters make it clear that they are offering tax savings, not an investment opportunity. Commissions frequently are determined as a percentage of the desired tax write-off. Offering materials tout alleged tax benefits. Some even promise to provide clients with legal representation in the event of IRS audits.

A memo circulated last year at one of the largest commercial brokerage houses clearly states the value of this tax shelter device to wealthy taxpayers.

> "Over the past few decades, commodity straddles for tax purposes have come to be a rather large part of the overall commodity business. We have seen the major portion of this business done for clients who have taken short-term gains that will be taxed at high rates (which, as you know, on a federal level can go up to 70 percent), and have tried through this vehicle to change these short-term gains into long-term gains which in 1979 and future years will be taxed at a maximum federal rate of 28 percent. We might point out that commodity futures continue to be in a very favorable tax position because the holding period for capital gains on them continues to be in excess of six months, whereas it is in excess of one year for all other capital items."

The bill which we have introduced is intended to end these shelters by specifically denying deductions for noneconomic losses claimed even though a straddle position continues to be maintained. Taxpayers clearly are entitled to reflect real losses on their tax returns. Hedgers and legitimate investors must be allowed to reduce their income and gains by losses. But, phantom, paper losses which do not reflect any genuine economic change cannot be fabricated to create enormous tax savings.

When taxpayers sell stock at a loss and immediately replace it with substantially identical stock, present law provides that they may not deduct any loss from that sale. The wash-sale rules in section 1091 of the Internal Revenue Code forbid such manipulation. My bill extends the wash-sale principle to similar transactions in other types of property. This approach may not be the sole way to stop straddle shelters. I welcome the suggestions of all interested persons on improvements of effective alternatives to this proposal.

To aid you in understanding H.R. 7541, I refer you to my statement in the Congressional Record, June 10, H4732. If you would like to cosponsor the bill or have any questions concerning the urgent need for this legislation, please contact Brian Goncher at extension 56331.

Sincerely yours,

Charles A. Vanik
Member of Congress

STATEMENT OF CONGRESSMAN CHARLES A. VANIK, D-OHIO, BEFORE THE HOUSE WAYS AND MEANS COMMITTEE

July 23, 1980

Mr. Chairman, several weeks ago, I introduced a revenue-raising bill to end a serious and growing abuse which threatens to undermine our voluntary system of taxation. This loophole, the so-called "tax straddle", is being used by thousands of the highest income individuals in the country. If allowed to continue, this tax device soon would cost the Treasury more than $3 billion a year -- a revenue loss which middle and lower income taxpayers would have to make up. The tax dollars spent on straddle shelters contribute nothing to capital investment, nothing to R & D, nothing to productivity, and nothing to U.S. employment. These tax dollars are transformed into commissions for brokers and alleged tax reductions for their clients.

Commodity trading in this country now is a $2 trillion industry. The growth of tax straddle trades in this area has been enormous. The brokerage industry has spawned an entire subculture of tax straddle departments within the major brokerage houses.

Sophisticated and unscrupulous promoters are marketing a number of tax shelter schemes involving so-called "straddle" transactions. These activities are motivated solely by tax considerations and offer no opportunity for meaningful economic reward. They have attracted high-income clients eager to reduce or eliminate their income tax liabilities by deducting enormous paper losses from their incomes one year while deferring their offsetting gains to a later year. Some try not only to defer their taxes, they also try to convert ordinary income or short-term capital gain to long-term capital gain which is taxed at significantly lower rates.

Tax straddle promoters make it clear that they are offering tax savings, not an investment opportunity. Commissions frequently are determined as a percentage of the desired tax writeoff. Offering materials tout alleged tax benefits. Some even promise to provide clients with legal representation in the event of IRS audits.

The promotional materials for one offshore straddle shelter blatantly advertise tax deferral as a certainty:

> "The first objective of the [tax shelter] is deferment. And since our taxing system requires voluntary reporting, deferment is a virtual certainty. Losses are created and claimed. The burden of review falls upon the IRS, thus tax payment is deferred until the IRS acts. (Sometimes years.)
>
> "The second objective, eliminating ordinary income tax created by the second straddle, can be done with a partnership. Undoubtedly, the IRS will audit returns with extraordinary losses. They customarily try to minimize tax reductions; hence, it is logical to assume the use of the [tax shelter] will be carefully examined.

"If the IRS rejects the claims of the [tax shelter], their decision can be appealed through the tax appeals process. This process can take years to complete. Deferment can be further stretched out through part of the appeals process.

"To determine if a reasonable chance for successful tax reduction exists, the creators of the [tax shelter] have secured several legal opinions. Each sees the plan as defensible. However, none can guarantee the plan will not be challenged. In fact, it is almost a certainty that it will. The question is, "Will it fly?" We think so. We do not know so.

"Legal briefs to answer audits and appeals will be provided, thus reducing costs. The legal briefs are prepared by knowledgeable tax attorneys with specialties in [tax shelter] law.

"Successful tax reduction is the goal. Deferment is a certainty."

In the last few years, the number and variety of these shelter deals have increased, even though the Internal Revenue Service has stated publicly that it will disallow deductions for the paper losses in these shelters. Straddle shelters have been structured in many commodities. Popular offerings include straddles in precious metals, especially silver and silver futures contracts, and in financial paper, particularly Treasury bills and Treasury bill futures. Individuals can purchase a single straddle, engage in multiple transactions through matched accounts, or invest in partnerships or Subchapter S corporations participating in these shelters. Some persons take advantage of straddle shelters through offshore promoters, especially in foreign countries which refuse the IRS access to their records for audit purposes.

The following cases, all currently under audit by the Internal Revenue Service, illustrate the enormous revenue losses attributable to tax straddles.

1. An executive with annual income from salary, dividends and interest of over $250,000 and substantially appreciated stock used silver straddles and other tax shelters over the course of several years as a means of not reporting any taxable income. In 1975, this taxpayer had long-term capital gains from the sale of stock of more than $600,000. Toward the end of the year this executive purchased silver straddles which happened to produce a "paper" loss of $600,000. Other tax shelters were used to eliminate the $250,000 in income. In the next year, more silver straddles were used in an attempt to continue to defer the $600,000 gain.

2. Another wealthy executive with annual income from salary, dividends and interest of over $200,000 sold the stock of his business for a $10 million profit in 1976 but reported no net capital gains because of a reported offsetting $10 million short-term capital loss from silver straddles. This reported loss was generated from the "loss leg" of the

straddle--silver contracts were purchased for $140 million and sold for $130 million. Of course, the "gain leg" which was not reported in this year had an unrealized profit of about $10 million so that the taxpayer had no real loss. Additional silver straddle transactions were entered into in subsequent years in an attempt to continue to defer the gain.

3. Still another taxpayer with over $200,000 of annual income from dividends and interest had over $750,000 in short-term and long-term capital gains from numerous transactions in the stock market. At the end of the year, when it became apparent that these gains would be very substantial, the taxpayer purchased a number of silver straddles which resulted in a reported loss that offset all this gain.

4. Another taxpayer, with a short-term capital gain of about $38,000, recorded a loss from commodities in 1976 simply as a loss "per broker". The loss was within $50 of the short-term capital gain that the taxpayer was deferring. In 1977, the taxpayer's return records a gain "per broker," presumably reflecting the sale of the other leg of the straddle. However, the taxpayer apparently did not wish to pay any tax on this income in 1977 either. Accordingly, the taxpayer also shows on his return another loss "per broker" in an amount within about $200 of the gain reported for that year. It is worth noting that the taxpayer recorded the dates of purchase and sale of all of the other transactions that he listed on his schedule of capital gains and losses for those two years.

5. Another taxpayer deferred about $44,000 of capital gain from 1976 to 1977 through 70 silver futures contracts that were sold at a loss eight days after they were purchased. In the following year, the 70 futures contracts on the other side of the transaction were closed out at a gain of about $66,000. In order to defer that gain, the taxpayer recognized losses on 254 additional silver futures contracts. This taxpayer, who had wages, interest and dividends for the year of little more than $60,000, recognized losses on futures contracts with purchase prices totaling over $3 million.

6. One corporate executive had income from salary and investments of over $500,000. This taxpayer attempted to report a loss in excess of $500,000 from a Treasury Bill tax straddle and consequently showed a net loss for the year. The taxpayer even received a refund of withheld taxes of over $38,000. This case, which is currently under examination by the IRS, illustrates the gross distortions in income that taxpayers may attempt to claim through the use of commodity tax transactions.

7. Another taxpayer had a very substantial gain upon liquidation of a business and began engaging in commodities straddle transactions in an attempt to defer tax. This taxpayer attempted to defer approximately $2,000,000 of gain year after year. It is significant to note that the taxpayer did not have any margin requirements during this time.

Over three years ago the Internal Revenue Service issued Revenue Ruling 77-185, disallowing deductions for paper losses from straddles on the grounds that the transactions are tax-motivated with no real risk and no potential for real economic gain. Despite this ruling, many taxpayers continue to claim the alleged tax benefits of these shelter devices. Because these transactions bridge two or more tax years, taxpayers hope that their shelter activities will escape IRS detection in the "audit lottery."

Some taxpayers have taken additional measures to hide straddle shelters from the IRS. By structuring multiple straddle transactions and creating enormous paperwork burdens for IRS agents, they hope to disguise sheltering as investment activity. Others run their offsetting positions through a number of accounts nominally held by different persons.

Taxpayers' continuing disregard of the IRS position and their attempts to shelter income through these abusive devices must be stopped. It appears that shelter-seeking individuals and corporations will be dissuaded from purchasing these devices only if straddle shelters are specifically and expressly outlawed. While I believe that the IRS eventually will prevail judicially against these abuses, I also recognize that litigation is lengthy and costly. Therefore, the enactment of specific rules to invalidate straddle sheltering is necessary.

The bill which I have introduced is intended to end these shelters by specifically denying deductions for noneconomic losses claimed even though a straddle position continues to be maintained. Taxpayers clearly are entitled to reflect real losses on their tax returns. Hedgers and legitimate investors must be allowed to reduce their income and gains by losses. But, phantom, paper losses which do not reflect any genuine economic change cannot be fabricated to create enormous tax savings.

When taxpayers sell stock at a loss and immediately replace it with substantially identical stock, present law provides that they may not deduct any loss from that sale. The wash-sale rules in section 1091 of the Internal Revenue Code forbid such manipulation. My bill extends the wash-sale principle to similar transactions in other types of property. This approach may not be the sole way to stop straddle shelters. I welcome the suggestions of all interested persons on improvements of effective alternatives to this proposal.

I have supplied a detailed example of a simple tax straddle and a brief technical explanation of my bill for the hearing record.

The adoption of this legislation could increase Treasury revenues by $1 billion in the first year to about $3 billion in subsequent years.

If no major tax bill is considered or adopted this year, these revenues could be utilized to offset the cost of two very constructive and stimulative tax proposals. For example, the Research Revitalization Act of 1980, H.R. 6332, cosponsored by 66 Members, would have a first year revenue cost of $231 million. This bill would provide business and industry with a 50 percent tax credit for the cost of research and development--conducted in colleges and universities--but directed by the business or industrial sponsor in order to ensure that the research and development results in marketable items. The research and development programs in universities would be cost-effective, utilizing the available resources of university personnel and providing for multiple use of facilities. America is depleting its resources of research and development. For example, expenditures for R&D as a percent of the Gross National Product (GNP) in the United States have declined since the 1964 high of 2.97 percent. The ratio in 1979 was 2.21 which is 26 percent lower than the 1964 peak.

The technology of the past was generated through the demands of the war and the space programs. America critically needs a constant stream of new ideas to compete in world trade and to strengthen the fabric of the domestic economy.

The balance remaining from increased revenues resulting from the closing of the tax straddle loophole could be used to provide targeted depreciation for selected industries or provide for the immediate "expensing" of the government mandated non-productive expenditures for pollution control and OSHA. These areas of tax relief would make American industry more competitive and more profitable. If there is one tax bill we should pass this year, it is this package. It stimulates productivity, it stimulates trade and it pays for itself.

[redacted]

EXHIBIT A

Example of Tax Straddle

The most highly touted example of these shelter schemes has been the straddle in silver futures contracts. In this deal, late in the tax year, a taxpayer with a large short-term capital gain buys a straddle consisting of, for example, one futures contract to buy a specified amount of silver in the next January at a fixed price and a second contract to sell an equal amount of silver at a fixed price in June. Because the taxpayer has purchase a straddle, the "margin" (security deposit) which he must put up is significantly less than the amount required if he were to purchase only one of the contracts. The straddle is a "covered" investment, safer than a single "naked" contract. In December, the taxpayer sells the contract on which he has a loss, and he immediately reestablishes the straddle by buying another similar contract. He continues to hold the original offsetting contract.

This original contract reflects an unrealized gain approximately equal to the loss on the sold contract. If the individual's real economic position were measured, his gain and loss from the offsetting positions of the straddle virtually would cancel each other out, with at most a relatively negligible gain or loss mainly attributable to transaction costs. By holding the contract reflecting a gain for 6 months, the taxpayer allegedly defers income until the next year. In addition, because futures contracts have only a six-month holding period, the taxpayer reports the income as long-term capital gain. And, by using a straddle which may require outlays of only 5 percent of the value of the offsetting contracts (plus commissions), the taxpayer has executed transactions on which he claims significant tax savings without exposing himself to the risk involved in genuine, economic, for-profit investments. His de minimis exposure is clearly insubstantial in relation to the alleged tax benefits. The size of the alleged tax benefits and the lack of genuine risk are evident in an example of a silver futures straddle using actual prices.

On November 30, 1979, a taxpayer enters 10 contracts to deliver silver in July (a "short" position) and enters 10 contracts to buy silver in September (a "long" position). The July contracts are for $19.83 an ounce and the September contracts are for $20.11 an ounce. Each contract is for 5,000 ounces.

On December 26, 1979, the taxpayer disposes of the 10 July contracts. On that date, silver for delivery in July is selling for $26.89 an ounce. Since the taxpayer's contract was to deliver silver at $19.83 an ounce, the loss on that transaction was $7.06 an ounce, or $353,000 on the 10 contracts of 5,000 ounces each.

Although the taxpayer has incurred a paper loss on the July part of the straddle transaction, it should be noted that, on December 26, September silver was selling for $27.295 an ounce. Since the taxpayer has a contract to purchase September silver at $20.11 an ounce, the taxpayer has an unrealized gain on the September contract of $7.185 an ounce, or $359,250 for the 10 contracts. Thus, as of December 26, the transaction as a whole has produced a modest gain of $6,250. Nevertheless, the taxpayer claims a tax loss of $353,000 which he records as a short-term capital loss. This could result in the taxpayer reporting his tax liability for the year in an amount which would be $247,000 less than if the loss were not reported.

In order to maintain his straddle position, the taxpayer on December 26 goes short on 10 contracts for delivery in December 1980. On that date, silver for delivery in December 1980 is selling for $27.91 an ounce.

On January 8, 1980, the taxpayer disposes of his straddle position. On that date, September silver is selling for $34.21 an ounce and December silver is selling for $34.90 an ounce. Thus, the taxpayer's gain on the September contract is $14.10 an ounce, or a total of $705,000. On the December contract, however, the taxpayer would have lost $6.99 an ounce, or a total of $349,500. For 1980, the taxpayer would claim a net short-term gain of $355,500.

Thus, on the transaction as a whole, despite the sharp movements in the price of silver and in interest rates between November 1979 and January 1980, and despite the taxpayer's large gross positions in silver, the taxpayer has gained a total of only $2,500 (less transaction costs). However, the taxpayer might claim a one-year deferral of tax liability which could be $247,000. If the taxpayer were in the 70-percent bracket in 1980, his tax on the gain would be $248,850. (If the taxpayer held the contracts for six months and closed out the straddle at a gain, the profit would be long-term capital gain taxable at a maximum rate of 28 percent instead of 70 percent.) In effect, the taxpayer would have "borrowed" $247,000 from the Treasury for a year at no cost and would have realized a small net gain (less transaction costs).

It is fair to note that the taxpayer could have had a real loss on the transaction as a whole. For example, if the taxpayer had been long July 1980 silver and short September 1979, at the beginning, his loss position on December 26, 1979, would have been his short September position. If he sold his short September position, it would produce a loss of $359,250 when sold. If he had then gone short December 1980 silver, his net loss on the transaction as of January 8 would have been $13,500 (July silver was selling for $33.735 an ounce on January 8, so the taxpayer's gain on the July position would have been $13.965 an ounce or $695,250 on the 50 contracts; his loss on the September position would have been $359,250 his loss on the December position would have been $349,500). However, the taxpayer could as readily have made the $13,600 if the contracts had run the other way. What is crucial to note is that even in an extraordinary market for silver and for interest rates, the real los on the transaction did not approach the economic gain that could result from the tax deferred if the transactions were given the tax effects desired by the taxpayer.

Explanation of H.R. 7541

This bill would limit tax sheltering through straddle transactions by postponing the recognition of losses on certain straddle positions while the taxpayer continues to maintain offsetting positions in a straddle.

The bill would provide that if a taxpayer holds a straddle, the portion of loss which exceeds recognized gain from the straddle may not be recognized for the period during which the taxpayer holds the offsetting positions plus the 30 days after the day on which the offsetting positions (or successor positions) cease to be offsetting.

Thus, if a taxpayer sold one leg of a 2-leg straddle at a loss on September 1, the taxpayer would have to hold the other leg (position) of the straddle without establishing any offsetting legs (positions) for the next 30 days before the loss could be recognized. The loss would be treated as sustained on October 1, 30 days after the straddle, that is, the offsetting positions ceased.

In addition, the running of holding periods for the straddle positions would be suspended for the balanced period, that is, the period during which the positions are offsetting plus 30 days. However, in determining the taxpayer's holding period for the position, any period during which a position was held prior to the establishment of an offsetting position could be tacked to any period during which that position was held after the close of the balanced period.

The bill uses the term "offsetting positions" to characterize a straddle. Under the bill, the term means that there is a substantial reduction of the taxpayer's risk of loss from holding any position with respect to personal property because the taxpayer also holds one or more other positions with respect to personal property (whether or not of the same kind).

The bill would create a rebuttable presumption that two or more positions are offsetting under specified circumstances. If two or more positions are customarily treated as straddles or offsetting positions or if the aggregate margin requirement for holding such positions is lower than the sum of the margin requirements for each such position (if held separately), the positions would be presumed to be offsetting unless the taxpayer establishes that they are not offsetting. The Secretary could prescribe by regulations other factors which indicate that two or more positions are offsetting and which would establish a rebuttable presumption that the positions are offsetting.

The bill would not apply to hedging transactions. The bill would provide that the term "offsetting positions" does not include positions in commodities which are an integral part of the taxpayer's business. Thus, for example, futures contracts in grain would not be subject to the bill's rules when held by a wheat farmer or cereal processor as an integral part of the farmer's or processor's farming or processing business.

The bill would apply to positions in personal property which are interests, including futures contracts or options, in commodities, evidences of indebtedness, and any other type of personal property, except for stock in a corporation. Personal property acquired by a taxpayer pursuant to a futures contract, option, or other interest will be treated as the same position as the predecessor interest.

In order to preclude manipulation of the character of gain or loss as ordinary income or loss, or capital gain or loss, the bill provides that obligations of the United States, of its possessions, of a State or political subdivision of a State, or of the District of Columbia, issued on a discount basis and payable without interest in less than one year, will be treated as capital assets in determining gain or loss. This change will apply prospectively to obligations issued after December 31, 1980.

The bill would provide special constructive ownership rules for determining whether any positions are offsetting. The general principles of the attribution rules in section 318 would apply except in determining attribution to and from family members and to and from a corporation, partnership, trust, or estate. Under the bill, an individual's family would consist only of the individual, his or her spouse, and the individual's children under 18 years of age. Attribution would be made to and from a corporation, partnership, trust, or estate, only if there is at least an 80-percent interest (determined after application of the family attribution rules), or if, in the case of a trust, the trust is a grantor trust (Secs. 671 et seq.).

The amendments made by the bill would apply to offsetting positions established after June 30, 1980, in taxable years ending after that date.

EXHIBIT B

Revenue loss estimates from immediate expensing of pollution control equipment and OSHA required equipment.

CAUTION: These estimates were made in 1979 with an effective date of January 1, 1980. Actual revenue loss for calendar year 1981 would be between $2.5 and $3.0 billion and would decline about $100 million per year in following years.

By Calendar Year
(in $billions)

	1980	1981	1982	1983	1984
Pollution Equipment	2.0	1.9	1.9	1.8	1.8
OSHA Reg. Equipment	.9	.8	.6	.6	.6
	2.9	2.7	2.5	2.4	2.4

These estimates assume companies will receive full 10 percent investment credit and would not generate preference income, which is subject to minimum tax.

Transcription of Merrill-Lynch "Commodity Tax Straddle" Tape of 8/20/75

This information is not to be released to the Press or any financial publication. This is Peter Thomas speaking on behalf of Tom O'Hare's Tax Straddle Department. Considering the strong stock market we have had this year, many of you may have customers with short-term capital gains that will be taxed at high rates. Some of them may meet our requirements for commodity taxstraddle customers. However you feel about doing commodity business and we personally think of commodity tax straddles as a tax subject, you would be well advised to seek out these individuals now. First, the right type of taxpayer can often derive substantial tax benefit by doing a tax straddle. Second, you will be paid in commissions for finding appropriate business. Third, we want to emphasize that we are partners in this operation. While your job is to find qualified accounts and service them, ours is to initiate and oversee all futures trading on a nondiscretionary basis here in New York. We personally feel that the cost and risk factors of the straddles we work with are tightly controlled and relate favorably to sought-after tax goals.

I would like to spend the next 10 minutes or so reviewing what we think you should know to successfully prospect and sell commodity tax straddles. I want to begin by outlining some basic Federal tax law, but remember it is against firm policy to give our customers tax advice. A taxpayer can make money legally in only two ways; as ordinary income or capital gains. Ordinary income divides into earned income that is compensation for services rendered and passive income, such as interest, dividends or rent receipts. Capital gains involve profits derived from either the sale or exchange of capital assets. Such gains are short term in nature if the property sold or exchanged is held for six months or less and long term if it is held more than six months. Earned income can be taxed at a rate as high as 50 percent. Note this means 50 percent of earned income within a given bracket and not 50 percent of total earned income. But passive income is taxed at rates up to 70 percent and that includes short-term capital gains. On the other hand, long-term capital gains are taxed at rates up to 25 percent on the first $50,000 and 35 percent on the rest. For high-bracket taxpayers, the wide spread between tax rates for long and short term capital gains can mean a great deal of money. Suppose, for example, that one of your customers has a $50,000 short-term gain taxed at the maximum rate of 70 percent; he would pay $35,000 in tax and keep only $15,000. But if somehow we could make this gain long term, his tax liability would total only $12,500 and he would keep $37,500; 250 percent more than in the short term situation. Gentlemen, this is what the usual commodity tax straddle is all about changing short-term situations with high tax rates into long term with a maximum tax rate of 25 to 25 percent. Said another way, tax straddles enable us to create for a reasonable cost the capital gains and losses we need to materially change the tax liability of high-bracket taxpayers.

To see how straddles work you have got to think about two distinct and separate tax years. First, we establish equal long and short positions in different contract months of a carefully selected commodity. Then, assuming a good price move either up or down, it does not matter, we take a short-term loss in the first year, tax year No. 1, to offset the original short-term gain. Third, we move our new unrealized gain straddled up into the second year, tax year No. 2. Fourth, assuming the ultimate market trend has been up, we make this gain long term by holding our long position for more than six months. Actually a successful tax straddle like the one I just described achieves three major tax benefits for high-bracket taxpayers. Most impotrtant if we can create a long-term capital gain in tax year No. 2, it will be taxed at 25 to 35 percent instead of 50 to 70 percent. Second, the actual payment of tax on the original short-term gain $35,000 on a $50,000 gain taxed at 70 percent is deferred for a year. Last, if the customer finds himself with capital losses in that second year, losses from other investments he can offset these against his gains in the straddle. Therefore, for all intents and purposes no tax would be paid on the original short-term gain.

So much for tax benefits. How about the cost and risk factors involved in using commodity tax straddles? First, the costs, there are two of them, commissions and interest lost on margin money. Generally speaking a customer can expect to pay up to 10 percent of a given short-term gain in commissions; so to move a $50,000 short-term gain he could have a commission bill as large as $5,000. Margin requirements for such a gain could be as great as 40 percent depending on the market used or up to $20,000. So much for costs. Now for the market risks, we see three. The most significant one is that the market in which we establish our straddles might not have a price move sufficient to create the capital gains and losses required to achieve the desired tax benefits. The second risk involves variations in the difference between the prices of contract months used to establish a straddle. Both prices almost always trend in the same direction, but the actual moves can differ enough to create difference gains or difference losses. Therefore, we always prepare a customer for the possibility of a difference loss as great as 10 percent of a short-term gain. The third risk is that we might establish a tax straddle bare market if so, we would only be able to get our gain in the following year on the short side of the straddle and as you know a short position does not result in long-term tax treatment. We want to make it clear that the cost and risk percentages I have mentioned represent the worst we have seen over the past decade. Normally, the overall cost of using tax straddles is considerably lower than the 20 percent sum of commissions and difference loss I indicated. But even with a 20 percent cost a high-bracket customer could still achieve good results if the tax straddle results in a long-term capital gain. Remember the difference in tax liability on the $50,000 capital gain taxed at 25 percent and one taxed at 70 percent is $22,500. Even if we cannot get a long-term gain out of it, a tax straddle would still defer the payment of tax on the original short-term gain and move the bulk of this gain into that second year, tax year No. 2. And do not forget this very important point most of the overall cost of doing a tax straddle is assumed by Uncle Sam since commissions and difference loss are reflected in the net capital gains or losses realized.

This brings us to the question of requirements for commodity tax straddle customers. Basically, we must be as certain as possible that a given taxpayer can indeed benefit from doing a tax straddle. First, the customer must have at least $20,000 in net short-term capital gains; this is our rock bottom minimum. In this regard, you should also make sure that the client has no offsetting capital loss carryovers from previous tax years. Second, net short-term capital gains must be subject to at least a 50 percent tax rate and the higher the better. To reach the 50-percent bracket for a single taxpayer net taxable income after deductions and exemptions must total at least $32,000; for a married individual filing a joint return it must be $44,000. If in either of these cases the client realized net short-term gains in excess of $20,000 they would be taxed at a rate of 50 percent and on a graduated scale to a high of 70 percent. We hope you realize that is conceivable for an individual with lower ordinary income to use a tax straddle also. An example of this would be a married taxpayer filing a joint return that has net ordinary income of only $20,000 who realizes a net short-term gain of $50,000. The last $26,000 of the short-term gain would be eligible since it would be taxed at and over 50 percent. So the facts you have to get include the client's marital status, his occupation, his net ordinary income excluding any capital gains, whether or not he has any loss carryovers and if so how much and is it long term or short term. In addition, we must know when his tax year ends if it is other than December 31, plus anything else the client may consider important for us to know when doing tax planning. After you find a good prospect and answer all of the required questions send the details by wire to GSTPO. We will get back to you as soon as possible confirming whether or not you indeed have a valid tax straddle candidate. When the client decides to go ahead with this operation, we will await market conditions that appear to us to give us the best opportunity to accomplish his goal Any suggestions should be discussed with the client for his okay.

This concludes our review of commodity tax straddles and how they might be utilized by clients with short-term capital gains taxed at high rates. However, tax straddles might also be valuable in other ways. We have used them to renew expiring corporate losses and to move a long-term capital gain into a tax year with an offsetting loss. To attempt moving a long-term gain by itself without any extenuating circumstances is not giving the client a fair shake. If it works perfectly with a minimum cost he saves nothing, but would be assuming the large risk of changing his gain into short term and, therefore, taxable at much higher rates. Do not forget a tax straddle really has only one purpose to try to help your client keep more of his money. Remember, it is against Merrill Lynch policy to give legal or tax advice to our customers. However, you may refer a prospect or his tax advisor to an annotated article on page 342 of the December 1968 issue of the Journal of Taxation which discusses commodity tax straddles thoroughly. Good luck and we hope to be hearing from many of you.

B. LETTER TO COMMISSIONER JEROME KURTZ, IRS, FROM REPRESENTATIVES VANIK AND RICHMOND, DATED APRIL 17, 1980

Congreſs of the United States
House of Representatives
Washington, D.C. 20515

April 17, 1980

Honorable Jerome Kurtz
Commissioner
Internal Revenue Service
1111 Constitution Avenue
Washington, D.C. 20224

Dear Mr. Commissioner:

One of the major sources of inflation has been the speculation frenzy which has possessed certain commodity markets during the past eight months. While the fluctuations in the markets for precious metals have captured the most attention, the speculative fever has affected a wide range of markets.

For example, the Chairman of the Commodity Futures Trading Commission recently reported to the Congress that speculators in future contracts already dominate the markets in several commodities. The trading volume on certain traditional agricultural futures markets is composed of approximately 85 percent hedgers protecting interests in the commodity itself and 15 percent speculators. However, in some other future markets, particularly those in precious metals and financial paper, speculators are responsible for up to 85 percent of such markets' volume. Speculative trading has contributed to inflation and has endangered orderly market activity.

In addition, traders pursuing neither commodity protection nor economic profits, but rather seeking tax shelter opportunities, have entered the futures markets in increasingly large numbers. Tax traders' straddling activities contribute little or nothing to price rationalization or market liquidity, yet they support inflationary trends and could seriously disrupt critical markets. For example, tax shelter seekers in Treasury bill futures may demand delivery on their futures contracts in order to realize fully deductible ordinary losses. Should such demands for delivery exceed the usually small percentage of deliveries, the actual supply of deliverable Treasury bills might prove inadequate.

To the extent possible, we believe that the Administration should discourage these new types of speculators.

We understand that the Internal Revenue Service does not automatically know whether an individual has been active in the commodities markets or has made enormous profits (or taken artificial losses) in the market. There is no automatic transfer of data from the commodity firms and markets to the IRS similar to the interest and dividend statements provided by banks to the Service. In other words, the Service must rely on voluntary disclosure or normal audit procedures, as to whether a taxpayer is making vast fortunes in the market. The potential for tax avoidance and tax cheating is enormous--and must be guarded against.

This is an incredible lapse in IRS reporting requirements, and we request an immediate meeting with the IRS to determine how we can quickly require reporting to the IRS by commodity houses of those individuals whose quarterly gains in the futures market exceed some certain amount. (The level of gain required to be reported should be determined by consultations between the IRS and the commodities industry.) Pending automatic reporting, the use of summonses should be considered.

Second, speculators in the market often do not use their own names and in some instances (such as recent problems with the coffee market) fronts for foreign governments and "Swiss-type" banks have been active in driving up prices. We urge the IRS to work immediately with the Commodity Futures Trading Commission and others to eliminate the types of abuses possible by such "fronts".

Third, commodities transactions are very complex, and we urge the IRS to form some audit task forces specializing in large gains and losses (including commodity and brokerage house personnel) in the commodities markets to ensure that the gains and losses properly reported.

Fourth, the IRS, through the Department of the Treasury, should begin working with other nations to stem tax-avoiding commodity speculators who are doing so much to contribute to world inflation. Proper disclosure and tax auditing in this country may drive some manipulators to use foreign exchanges. In the interest of stemming inflation, we believe other nations may be interested in helping control these markets. If not, we should explore ways to obtain cooperation.

We believe that there is a great deal of tax avoidance in the commodities field. For example, an article in the March 1, 1980 New York Times noted:

> "In particular, the trade views with alarm the detailed reporting of the names, addresses, and other data about traders that COMEX and other exchanges have promised to provide the CFTC...
>
> "The traumatized American (silver) market and threat of future disclosure of their trading operations have led many of the big speculators, including Mr. (Nelson Buker) Hunt, to shift their operations to Europe where there are virtually no restrictions on trading. More important to the buyers, exchanges and brokers abroad need not disclose the names of traders and other details about their trading as they are required to in this country."

We do not understand why there should be any alarm whatsoever about reporting names and addresses of commodities speculators--unless those individuals are avoiding taxes on a massive scale.

Fifth, the Internal Revenue Service should increase its efforts to identify and disallow the tax sheltering schemes based on straddles in commodity future contracts. If additional statutory authority would enhance the IRS' ability to eliminate these abuses, the IRS together with the Department of the Treasury should develop legislative proposals to deal with tax straddles.

By announcing a series of initiatives--such as we have described--we believe that the IRS can take a major step toward dampening needless inflation in basic commodities, while gaining hundreds of millions of dollars in tax revenues from those who failed to report vast fortunes in these markets, and from those who have attempted to shelter their incomes and reduce their tax liabilities with artificial losses on commodity tax straddles.

Honorable Jerome Kurtz
April 17, 1980
Page Four

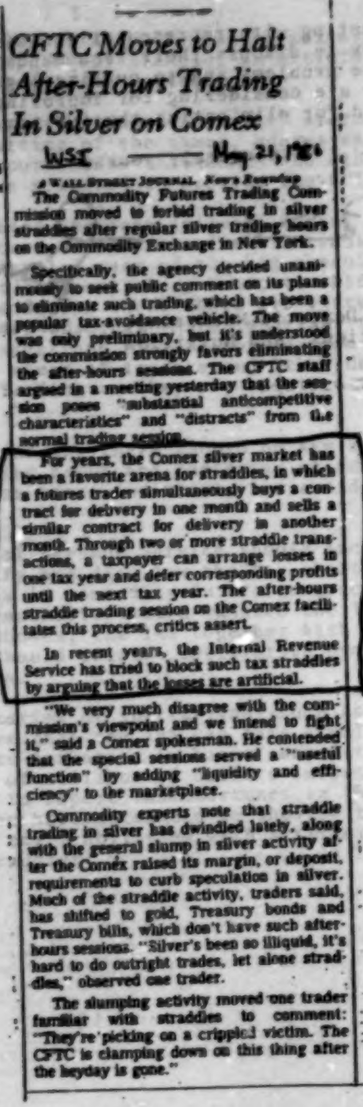
We request a meeting with representatives of the Service and the Treasury to discuss their recommendations for correcting these problems and to outline legislative proposals which we are considering for improving reporting requirements and for eliminating abusive tax shelters.

Sincerely yours,

Fred Richmond
Chairman
Subcommittee on Domestic Marketing,
Consumer Relations, and Nutrition

Charles A. Vanik
Chairman
Subcommittee on Trade

C. SELECTED ARTICLES



CFTC Moves to Halt After-Hours Trading In Silver on Comex

WSJ — May 21, 1980

A WALL STREET JOURNAL News Roundup

The Commodity Futures Trading Commission moved to forbid trading in silver straddles after regular silver trading hours on the Commodity Exchange in New York.

Specifically, the agency decided unanimously to seek public comment on its plans to eliminate such trading, which has been a popular tax-avoidance vehicle. The move was only preliminary, but it's understood the commission strongly favors eliminating the after-hours sessions. The CFTC staff argued in a meeting yesterday that the session poses "substantial anticompetitive characteristics" and "distracts" from the normal trading session.

For years, the Comex silver market has been a favorite arena for straddles, in which a futures trader simultaneously buys a contract for delivery in one month and sells a similar contract for delivery in another month. Through two or more straddle transactions, a taxpayer can arrange losses in one tax year and defer corresponding profits until the next tax year. The after-hours straddle trading session on the Comex facilitates this process, critics assert.

In recent years, the Internal Revenue Service has tried to block such tax straddles by arguing that the losses are artificial.

"We very much disagree with the commission's viewpoint and we intend to fight it," said a Comex spokesman. He contended that the special sessions served a "useful function" by adding "liquidity and efficiency" to the marketplace.

Commodity experts note that straddle trading in silver has dwindled lately, along with the general slump in silver activity after the Comex raised its margin, or deposit, requirements to curb speculation in silver. Much of the straddle activity, traders said, has shifted to gold, Treasury bonds and Treasury bills, which don't have such after-hours sessions. "Silver's been so illiquid, it's hard to do outright trades, let alone straddles," observed one trader.

The slumping activity moved one trader familiar with straddles to comment: "They're picking on a crippled victim. The CFTC is clamping down on this thing after the heyday is gone."

May 23, 1980

IRS to Clamp Down on Futures Trading That Lets Wealthy Avoid Tax Payments

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON – The Internal Revenue Service plans to get tougher with people who try to use futures trading to avoid taxes, IRS Commissioner Jerome Kurtz said.

Mr. Kurtz told a House subcommittee the IRS is cracking down on futures trading that lets wealthy people "avoid their share of the tax burden." In addition to auditing tax returns more closely to seek out tax shelters that violate IRS rules, the agency is drafting legislation intended to give the rules more clout, Mr. Kurtz said.

The IRS first moved against "tax straddles" in futures three years ago by ruling that certain silver-trading losses can't be claimed as a deduction. In the typical tax straddle, a trader buys contracts for future delivery of goods in one month, while selling in another month. Whether market prices go up or down, one of the positions will lose while the other gains. The trader deducts his paper losses this year, while deferring his profit into the next tax year through another trade. The cycle can be repeated each year, indefinitely avoiding taxes. Some experts estimate several hundred million dollars in taxes are avoided annually this way.

Mr. Kurtz, with Deputy Treasury Secretary Robert Carswell, said use of the shelters is growing despite the IRS rulings. Mr. Carswell said "the public as a whole cannot be expected to countenance" such tax shelters. Thus, Mr. Kurtz said, IRS processors and auditors are being trained to catch such shelters on tax returns, and people who try to use them "will face a substantial likelihood of having . . . their claims of artificial losses disallowed on examination."

Furthermore, Mr. Kurtz said, additional rulings against specific variants of the tax straddle will be issued where warranted. He added that the agency hopes to present Congress in a few months with proposed legislation to outlaw such tax claims on commodity straddles. A specific law on the subject, he said, would discourage the shelters better than IRS rulings could. He added that the law would have to be drafted so it wouldn't discourage normal futures and straddle trading, as many people straddle their positions for reasons other than tax avoidance.

Mr. Carswell told the subcommittee a previously announced interagency study of the futures markets has begun, and hopes this summer to recommend ways to prevent a recurrence of the silver market crash. The two officials testified before a House Government Operations subcommittee, one of five on Capitol Hill considering changes in commodities law because of the silver crash.

THE WASHINGTON POST Wednesday, June 11, 1980

Tax Break Denial Asked on Commodity Losses

By Jerry Knight
Washington Post Staff Writer

Moving to close what they called, "the most glaring loophole" in federal tax laws, two influential congressmen introduced legislation yesterday to prohibit taxpayers from deducting deliberate commodity trading losses from their income taxes.

A few of "the very wealthiest taxpayers" use artificial commodity trading losses to avoid paying almost $4 billion a year in taxes, charged Rep. Charles Vanik (D-Ohio).

Vanik and Rep. Benjamin Rosenthal (D-N.Y.) asked Congress to eliminate the $4 billion loophole by outlawing deductions produced by so-called "tax straddles."

To use a tax straddle, an investor simultaneously buys and sells commodity futures contracts. Because the two transactions exactly match, there is no risk. The investor makes money on one deal and loses the same amount on the other.

The loss can be deducted immediately from any other income. The profits can be deferred indefinitely, so no taxes are paid or they are paid at a much lower rate.

Vanik said one wealthy executive who earned more than $500,000 a year used a tax straddle to deduct his entire income and claim a $38,000 refund from the Internal Revenue Service.

In the past few months the IRS has filed more than 80 lawsuits against taxpayers to try to make them pay taxes on income they wrote off against tax-straddle losses.

The IRS now must prove the taxpayers are trying to avoid paying taxes, Rosenthal explained. The bill would rewrite the law so commodity trading losses are taxed in much the same way as losses on stock transactions.

The two congressmen said the IRS believes about 20,000 taxpayers a year use tax straddles to avoid paying some or all of the taxes they normally would owe.

Use of tax straddles is being promoted by some of the biggest stock and commodity brokers in the country, Vanik complained. In at least one case, the fee for the investment is based on the amount of taxes saved.

Investments in silver or Treasury bill futures contracts are used most commonly to avoid taxes, but the same technique can be used with any commodity, Vanik said.

Rosenthal said his support for the bill came after hearings held recently by a subcommittee he heads on silver speculation by the Hunt brothers of Texas. "You might call this the Vanik-Rosenthal-Hunt Bill," he said.

The proposal isn't meant to increase the taxes paid by professional commodity traders, the two representa-

See STRADDLE, B3, Col. 6

STRADDLE, From B1

tives said. Grain and other commodity traders often take straddle positions for normal business reasons.

The technique is called a straddle because the investor takes both sides of the deal at once.

In the more elaborate version of the technique, known as a "butterfly spread," the investor buys and sells four commodity futures contracts.

In most cases the transaction is made at the end of the year so the taxpayers can write off the loss one year and delay the profit until the next. By doing another straddle the following year, the first year's profits can be deferred again. The process can be repeated indefinitely.

Business review

Chicago Tribune, Sunday, June 15, 1980 Section 5 5

Congress takes aim at tax straddle loophole

LAST TUESDAY may have marked the beginning of the end for one of the most popular tax shelters available to wealthy Americans. If so, its passing won't be mourned by the Internal Revenue Service.

The device, known as a "tax straddle," is the object of a bill introduced last week by Reps. Charles Vanik (D., Ohio) and Benjamin Rosenthal (D., N.Y.). The proposed legislation would do away with the tax-avoidance technique, which the sponsors claim is used by 20,000 individuals for a revenue loss to the Treasury Department of up to $3 billion to $4 billion a year.

These figures—admittedly crude estimates—are widely disputed. What isn't contested, however, is that passage of the Vanik-Rosenthal bill or similar legislation would disrupt a game that's been coached for years by sophisticated commodity traders.

Moreover, Congress has aimed its sights at a bigger target than commodity futures transactions. Also covered in the broadly written Vanik-Rosenthal bill is trading in stock options, a quietly growing arena for tax straddling.

THE BILLIONAIRE Hunt brothers of Dallas aroused interest in the device when they admitted in congressional testimony to using tax straddles in silver to shelter gains.

In its simplest form, the technique involves the simultaneous purchase and sale of different delivery months of the same commodity. For example, a broker might buy December, 1980, silver on the Commodity Exchange in New York and sell July, 1981, silver.

Now the price of silver declines. There is a loss in the December position that in theory is offset by a gain in the July contracts. The broker closes out the long position by selling December contracts and re-establishes it in a distant delivery month, such as September, 1981.

At the end of the current tax year, the taxpayer can use the loss to offset real capital gains. The gain, however, has been rolled forward into the next tax year. If the position is held past six months, it will qualify for tax treatment as a long-term capital gain at reduced rates.

THE DEVICE often takes more complicated forms, including so-called butterfly spreads, or the use of a number of straddles.

According to IRS and congressional investigators, tax straddling has been quietly promoted by all the major brokerage firms. A customer who indicates to his broker that he is seeking a tax shelter is usually referred to an expert employed by the company for that purpose.

"Everybody uses spreads to avoid taxes in commodities. Everybody," asserts one Chicago broker. The practice has been growing, investigators say, despite a 1977 IRS ruling that losses from tax straddles cannot be used as deductions for tax purposes.

The IRS currently is auditing 3,000 files involving tax straddles, and another 30 cases on the subject are pending in federal tax court.

BUT "ONCE we have specific legislation dealing with the matter people aren't likely to do something directly contrary to the law," says an assistant to IRS Commissioner Jerome Kurtz.

Details of the Vanik-Rosenthal bills are still being digested by lawyers and accountants, but futures industry participants already are lining up in opposition.

"We will want to oppose the bill," says Robert Wilmouth, president of the Chicago Board of Trade. "At first blush, it appears to outlaw spreading. It would have a disastrous effect on the liquidity of the marketplace."

Insiders say the bill likely will prompt an intensive lobbying campaign. "The industry will pull every string to keep it from happening," according to one source.

Futures traders dispute the premise of the bill and the IRS ruling: that spreads are riskless transactions. "To make the assumption [that] there is no risk just couldn't be substantiated by the data," says Commodity lawyer Thomas Russo.

In addition, industry sources say it will be difficult to attract speculative capital to futures markets if wealthy investors aren't compensated for their risks by the possibility of obtaining sheltered profits. And that speculation is necessary to insure liquid markets for commodity users and producers, they maintain.

Laurie Cohen.

6/27/80 Chicago Tribune

Bill to eliminate straddle

Traders scurry for tax shelter

By Laurie Cohen

COMMODITY TRADERS are scurrying to take shelter before Congress closes their favorite tax loophole.

June 30 is the effective date in a pending bill that would eliminate the popular tax shelter known as the "straddle." Although it is believed Congress will not act on the bill during this session, "people are taking out insurance just in case," said a gold trader at the Chicago Mercantile Exchange's International Monetary Market division.

The bill, introduced two weeks ago by Reps. Charles Vanik [D., Ohio] and Benjamin Rosenthal [D., N.Y.], would outlaw a method of avoiding capital gains taxes by artificially manufacturing capital losses to offset them. It also would prevent traders from deferring their gains for an extended period of time, then turning them into long-term capital gains, qualifying for reduced tax rates.

Straddles involve the simultaneous purchase and sale of different delivery months of the same commodity.

THE RESULT has been an unusual pattern of trading during the last few days, especially in the International Monetary Market gold contract, where activity has been exceptionally heavy in distant delivery months.

On Wednesday, the latest date for which figures are available, the number of outstanding gold contracts [or open interest] rose by [illegible].

Of these contracts, [illegible] were for delivery in June, 1982, or September, 1982. The June and September 1982 contracts showed a total open interest of only two contracts Tuesday, the day they were listed by the exchange.

Such an abrupt rise in participation in a contract happens rarely. "It's pretty unusual," said an exchange spokesman, who added that the increase is even more unusual for so distant a delivery date.

"Why the hell would anybody go into these deferred options except for tax reasons?" a Chicago broker asked.

One senior industry official said, "I think people are aware of the date [in the bill] and are acting accordingly."

Because the legislation would be retroactive to June 30, he said, traders had only a couple of days after the June and September 1982 contracts were listed to put on positions.

A SIMILAR PATTERN was evident in gold and silver trading at the New York Commodity Exchange, the nation's biggest for precious metals. However, the activity was not as marked because the most distant contracts at the Comex were listed last month, giving traders more time to establish positions.

For example, gold for delivery in December, 1981, alone accounted for 40 per cent of the [illegible] contract increase in open interest in gold at the Comex Wednesday.

"This is the time of year when commodity traders normally do tax planning," said a New York trader. "This year they're influenced by the bill. They want to have positions that are exempt from the provisions of the bill."

Analysts said recent turmoil in the money market has made gold the most popular commodity for tax spreads. They attribute part of the increase in open interest to expectations of rising interest rates, which they said would tend to spark interest in deferred contracts regardless of tax consequences.

THE MERCANTILE Exchange said it added the distant contracts Tuesday to accommodate trading by gold producers, rather than to allow tax straddlers to establish positions before June 30. However, an exchange representative said the timing might have been "unfortunate."

Separately, sources said a committee, composed of exchange officials and industry leaders, has been formed to review the Vanik-Rosenthal bill. The group is expected to lobby against the proposed legislation.

Tax Spreads Under Attack in Congress

On June 10, Congressman Rosenthal (D-NY) and Congressman Charles Vanik (D-Ohio), a senior member of the House Ways and Means Committee, introduced legislation which would virtually eliminate tax straddles. On introducing the bill, the sponsors said that they were closing a loophole which costs the United States Treasury between $3 and $4 billion a year and that this type of "tax-induced trading serves no legitimate economic purpose in the marketplace". In summary, the Vanik-Rosenthal bill provides that:

(1) A loss resulting from the liquidation of one leg of a straddle cannot be deducted until 30 days after there is no offsetting position. For example, if on December 2 you liquidate one leg of straddle at a loss, this loss would be deducted on January 1 of the next year assuming you did not establish a new offsetting position during the 30 day period following the December 2 transaction.

(2) Offsetting positions include any positions in personal property which are interests, including futures contracts or options, in commodities, evidence of indebtedness, and other types of personal property except corporate stock. Personal property acquired pursuant to a futures contract, option, or other interest will be treated the same as if it were the predecessor interest.

(3) Two or more positions are presumed to be offsetting if (a) they are customarily treated as straddles or offsetting positions, (b) the aggregate margin requirements for holding such positions are lower than the sum of the margin requirements for each such position if held separately, or (c) the IRS issues regulations setting forth factors indicating such positions are offsetting.

(4) The capital gain holding periods for the straddle positions are suspended during the time there is a balanced straddle position and for 30 days thereafter.

(5) Treasury bills, and other government obligations issued on discount basis, payable without interest and maturing in less than one year, will be treated as capital assets in determining gain or loss. According to Vanik, this is to "preclude manipulation" of the character of gain or losses as ordinary or capital gain loss.

(6) Positions held by an individual's wife, children under 18 years of age, controlled corporation, partnership, trust or estate are taken into account in determining whether they are offsetting.

(7) Hedging transactions—defined in the bill as positions in commodities which are an "integral part of the taxpayer's business"—are not subject to the limitations provided by the bill.

Vanik also commented during the press conference on the bill that the IRS had issued guidelines on May 31st to its audit agents, instructing the agents to check tax returns in order to discover persons avoiding taxes through the use of straddles.

The fact that the Senate has announced that the Finance Committee will write a tax cut bill between now and September 3 and the probability that the House Ways and Means Committee will be doing the same thing offers Congressman Vanik (D-OH) a new opportunity to bring up his proposal to eliminate the use of spreads as a means of reducing taxes. At the same time, a tax cut bill would afford the futures industry the same opportunity to propose a legislative solution to alleviate the hiatus resulting from the IRS' audit policies on tax spreads as expressed in Revenue Ruling 77-185. What in fact will happen remains to be seen.

D. "TAX TREATMENT OF TREASURY BILL FUTURES," TERRENCE KANE, SOUTHERN CALIFORNIA LAW REVIEW, VOL. 52, JULY, 1979, PP. 1555–1579

HJ 4625 U5 A

CRS Main File Copy

Southern California law review
V. 52 July 1979 S-79 18450

Tax Treatment of Treasury Bill Futures

Investment advisors are constantly seeking formulas that will protect the profits of clients from the Internal Revenue Service (IRS). At the same time, agents of the IRS are busily engaged in attempts to forestall the ingenuity of the taxpayers and their advisors. This year, the attention of taxpayers and their advisors (and therefore of the IRS) has focused on Treasury Bill futures.[1] The taxpayers have two goals in mind—transforming ordinary income into capital gain and postponing the payment of taxes.

The first goal—the transformation of ordinary income into capital gain—is possible because the tax laws treat income generated by certain activities and certain types of assets differently;[2] thus, an investor has great incentive to attempt to transform his profits accordingly. If classified as long-term capital gain, the proceeds from a transaction are taxed at a significantly lower rate than are items received as ordinary income.[3] Treasury Bill futures were being touted as a means of accomplishing a transformation of this sort.[4]

Interest rate futures, including Treasury Bill futures, are contractual obligations to deliver or accept delivery of interest bearing notes at a specified time and price.[5] The movement of most interest rate futures depends on changes in the general interest rate structure.[6] The nonhedging investor—that is, the ordinary speculator—in the futures market generally obtains capital gain treatment for his profits or losses.[7] Prior to November 1978, however, the investor in Treasury Bill futures had uncertain status.[8] Because all profits from the sale of Treasury Bills are statutorily defined as ordinary income,[9] many suspected that Treasury Bill futures would be accorded similar treatment;[10] thus, the possibility of transforming ordinary income into capital gain at will arose.[11]

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[1] *See, e.g.*, Martin, *How T-Bill Spreads Can Be Used for Hedging and Tax Deferral Opportunities*, 48 J. TAX. 102 (1978); Waite, *T-Bill Futures Can Reduce Taxes*, COMMODITIES, Oct. 1978, at 30.

[2] I.R.C. §§ 1, 11, 64, 1201, 1221, 1222; *see* notes 52-54 *infra*.

[3] I.R.C. §§ 1, 11, 1201-1202.

[4] In addition to the types of transmutations discussed herein, it is also possible for taxpayers to use the commodity futures markets to transform short-term gain into long-term capital gain. This is primarily because the Internal Revenue Code has retained the six-month holding period for commodity futures. *See* I.R.C. § 1223. A discussion of the rationale for this holding period is outside the scope of this Note.

[5] *See, e.g.*, Chicago Mercantile Exchange, Treasury Bill Futures 4 (Dec. 1976).

[6] Chicago Board of Trade, An Introduction to the Interest Rate Futures Market 10 (Aug. 1977).

[7] *See* text accompanying notes 78-80 *infra*.

Just as a taxpayer may seek to transform his tax burden, the rational taxpayer also seeks postponement of the inevitable payment of taxes.[12] One technique through which a taxpayer may attempt to postpone his tax payment is the forward spread or straddle.[13] Familiar in certain stock transactions, the principle relied on is realization—despite the fact that a profit or loss has been generated, it is not taxed until the taxpayer realizes his funds by completing the transaction.[14] The objective of a spread is to generate a loss that is used to reduce a high current tax burden, and at the same time create a profit that is not realized until a subsequent tax year. If the taxpayer were allowed ordinary income treatment on Treasury Bill futures, he could roll his ordinary income into a future year.[15] If Treasury Bills were treated as capital gain, however, the taxpayer would have to be content to push capital gain into a subsequent year.[16]

The IRS issued Revenue Ruling 78-414 on November 20, 1978 in an attempt to close these loopholes.[17] The Ruling has two parts. First, it declares the profits from Treasury Bill futures transactions to be capital gain or loss, rather than ordinary income, to the nonhedging investor.[18] Second, the Ruling examines the position taken by the IRS in a previous Ruling,[19] which limited so-called forward spreads, and affirms the position previously stated in Revenue Ruling 77-185 that when such a transaction is performed for tax avoidance purposes, and without expectation of profit, the transaction is a "sham."[20]

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[8] *See Taxpayers No Longer Can Run For Shelter Under T-Bill Futures*, Wall St. J., Nov. 22, 1978, at 3, cols. 4-6.

[9] *See* I.R.C. § 1221(5); note 65 *infra*.

[10] *See* note 1 *supra*.

[11] *See* text accompanying notes 97-101 *infra*.

[12] As a general proposition, postponing taxes is a boon to the taxpayer because any postponement is the equivalent of an interest-free loan.

[13] In a forward spread, the taxpayer takes a balanced position, both short and long, in closely related futures contracts (usually two different months, but the same commodity). The taxpayer hopes thereby to generate simultaneously both profits and losses—the losses will then be realized by the taxpayer in the current year to offset other gains and reduce tax liability. The profits (which the taxpayer "insures" by taking a new balancing position) will be realized in the following tax year, thus postponing the payment of tax. *See* notes 115-17 *infra*.

[14] *See* E. GRISWOLD & M. GRAETZ, FEDERAL INCOME TAXATION 497 (1976).

[15] *See* text accompanying notes 103-07 *infra*.

[16] *See id.*

[17] Rev. Rul. 78-414, 1978-2 C.B. 214.

[18] *Id.*

[19] Rev. Rul. 77-185, 1977-1 C.B. 49.

In ruling that Treasury Bill futures may generate capital gain, the IRS has disregarded an important strand of tax law: that certain contract rights, such as options and futures, have a close relationship to an underlying commodity and should be taxed in the same way as the underlying commodity.[21] By ignoring the manner in which the ordinary income status of Treasury Bills relates to the *delivery* of a futures contract, the IRS failed to close effectively the loophole. This Note will demonstrate that possibilities for converting items of capital gain into ordinary income, and vice versa, still exist. This Note will also argue that the "sham transaction," motive-based analysis of Ruling 77-185 is a murky test that prevents postponement transactions only at high administrative expense. This Note then proposes a revision of the substantive tax law, eliminating the ordinary income treatment artificially imposed on all proceeds from Treasury Bill transactions. Henceforth, gains should be apportioned between an ordinary income and a capital gain component, as are the gains from other debt items;[22] thus, transmutation through futures or options would be prevented. This Note also proposes a mechanical "year-end wash sale" rule that would effectively prevent a forward spreading of tax burden through commodity futures transactions without inquiring into the motives of the taxpayer.

I. TAX TREATMENT OF TREASURY BILL FUTURES TRADERS

To fully understand the tax dilemma posed by Treasury Bill futures, the purpose and effect of futures trading must be examined, as well as the various theories of taxation that have been applied to them.

A. FUTURES MARKETS

Futures markets arose out of the need to fix stable prices for raw materials and have existed since the twelfth century.[23] The need for these markets was first dictated by a simple fact of agricultural life: supplies of food crops are harvested periodically, while demand for them is constant. Thus, at harvest time, the current or "spot" market price for commodities (which are suddenly available in large quantities) falls, while in periods of short supply, the prices rise. By contracting for future delivery, those who supply the goods can assure themselves a profitable price, while those who demand the commodity can minimize the risk of a shortage.[24]

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[20] Rev. Rul. 78-414, 1978-2 C.B. 214.

[21] *See* text accompanying notes 86-97 *infra*.

[22] I.R.C. § 1232. *See* notes 65-71 *infra*.

[23] S. REP. No. 1131, 93d Cong., 2d Sess. 11, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 5852.

Economists have long realized that if plans were stationary, that is if market participants were extremely good guessers, then no forward markets would be necessary.[25] Present markets, if efficient, can always equilibrate any expected changes in supply and demand conditions. It is only when a certain form of disequilibrium arises—that is, when the future is not exactly as one had anticipated—that risks that are difficult to cope with arise.[26] Ordinary suppliers and demanders of goods enter futures markets in order to minimize such risks.[27]

A supplier of cattle, for example, could hedge against risk of adverse price changes by contracting to buy his feed supply at a set price in the future. The supplier thereby protects himself against a supply squeeze. At the same time, he can contract to sell his cattle at a fixed price at some future date, thus assuring himself of a fixed profit margin.[28]

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[24] *See* G. GOLD, MODERN COMMODITY FUTURES TRADING 130-67 (1971).

[25] J.R. HICKS, VALUE AND CAPITAL 135-40 (1932).

[26] *Id.* at 133-35.

[27] *See* text accompanying note 24 *supra*.

[28] Despite the theoretical justifications for futures trading, the reaction to real world commodity futures markets has not been unanimously enthusiastic. Working, *Price Effects of Futures Trading*, 1 STAN. FOOD RESEARCH INST. STUD. 3, 14 (1963) ("Criticism of futures has usually, if not always, consisted primarily of allegations that the existence of future trading leads to greater variability of prices than would otherwise occur"). The legislative history of the act reorganizing the Commodity Exchange Authority characterizes the early period of futures trading in the United States as a time of "unbridled speculation, recurrent market manipulation, and spectacular price fluctuations." S. REP. NO. 1131, *supra* note 23, at 12. Another author notes that "[d]uring the early 1970's fluctuations in the market were so wide and erratic as to indicate the possibility of price manipulation and squeezing." Smith, *Commodity Futures Trading*, 25 DRAKE L. REV. 1, 2-3 (1975).

If these allegations were well-founded, then the analysis could end here—the simplest way to avoid tax evasion in a market that generates only deleterious results is to eliminate the market itself. Recent empirical studies, however, show that allegations such as the above are unfounded. From a purely theoretical general-equilibrium standpoint, it can be shown that the existence of forward markets generates a result which is "Pareto noninferior and possibly Pareto superior" to a model that only allows current markets. Townsend, *On the Optimality of Forward Markets*, 68 AM. ECON. REV. 54, 61 (1973). Another author studied certain agricultural markets before and after the introduction of futures trading; a "noise" factor, mathematically describing random fluctuations of price around an equilibrium, was found to drop significantly after futures trading was introduced. Power, *Does Futures Trading Reduce Price Fluctuation in Cash Markets?*, 60 AM. ECON. REV. 460, 465 (1970) ("The result [of allowing futures trading] should be more informed decision making and prices that are more closely representative of basic supply and demand con-

Futures markets play an important role in price stabilization, and the presence of a large number of risk assumers is essential to the proper function of the market.[29] Speculators enter the market and assume the risks of price fluctuation in hopes of economic reward. By permitting the assumption of risk by those who prefer it and the reduction of risk by those who are adverse to it, the general level of utility should be raised.

1. *Interest Rate Futures*

Trading in futures in the area of financial instruments is a fairly recent phenomenon. Trading in interest rate futures began in October 1975.[30] It is possible to trade futures contracts in Treasury Bills,[31] Treasury Bonds (which are of longer duration than Treasury Bills), Government National Mortgage Association Certificates,[32] and commercial paper.[33] The growing importance of these instruments mirrors the increased importance of debt in the economy generally:

> Since the late 1960's, interest rates in the United States have fluctuated as in no other period in their history, exposing both borrowers and investors in the credit markets to increasingly higher interest rate risks. Borrowers have seen interest rates double and investors have watched yields erode as interest rates fluctuate with quickly changing economic conditions.
>
> Futures trading, which historically has provided a risk transfer mechanism for producers and users of agricultural commodities, now provides to corporations, thrift institutions, banks, debt instrument

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ditions"). *See also* Working, *supra*, at 18 ("the amount of short time variation in cash prices appears to have been reduced by the existence of futures trading"). The explanation for the existence of dissenting opinions seems to be that critics, who point to wide swings in the movement of futures prices, do not take into account the possibility that cash market fluctuations may be smaller as a result of such swings. *Id.*

[29] *See* S. REP. NO. 1131, *supra* note 23, at 14 ("the competitive effect of many speculative buyers and sellers in the market, and the effect of hedging in maintaining effective competition amoung commodity handlers, began to reduce gradually the merchandising price margins involved in moving large quantities of grains and cotton"). Insofar as the tax structure either encourages or discourages participation in the market, such potential effects must remain in consideration. To some extent, however, behavior in these markets is a function of the regulation of the market; such considerations are beyond the scope of this Note. *See* Purcell & Valdez, *The Commodity Futures Trading Commission Act of 1974: Regulatory Legislation for Commodity Futures Trading in a Market-Oriented Economy*, 21 S.D.L. REV. 555 (1976).

[30] Merrill, Lynch, Pierce, Fenner, & Smith, Inc., The Merrill Lynch Guide to Interest Rate Futures 1 (May 1978).

[31] *See* text accompanying notes 44-51 *infra*.

[32] These certificates, based upon mortgages, are guaranteed by the United States government and are actively traded on secondary markets. Chicago Board of Trade, *supra* note 6, at 5-6.

[33] Chicago Mercantile Exchange, *supra* note 5, at 5.

dealers and institutional investors a means to protect themselves against adverse rate movements, through hedging in financial futures.[34]

The importance of stable money markets will become more obvious as our economy relies more heavily on debt financing.[35] Consumers have been showing a marked increase in their reliance on credit in the recent past.[36] The business sector, as well, has been unable to finance new expansion by means of equity capital in the uncertain stock markets of the 1970's; the use of debt by business has thus shown a dramatic increase.[37]

At least three major benefits should flow from the existence of interest rate futures markets.[38] First, there is a barometric planning effect: Investors (both private and institutional), businesses, and other entities with a need for, or a supply of, loanable funds know at all times that they can contract on an organized market for a commitment securing the rate of interest at a future date. Thus, rather than being completely at the mercy of conditions in the cash market at a future date, the investor has the alternative, while considering future plans, of examining the rate at which the futures market will contractually guarantee an interest rate commitment.[39]

Second, the existence of futures trading has been demonstrated to have a stabilizing effect on the price of the underlying commodity.[40] Rapid dissemination of information and superior adjustment of markets to random disturbances should cause the fluctuation of interest rates in the current or spot markets to be smoother, benefiting the private, business, and government sectors.

The third major advantage of interest rate futures is the ease with which hedging operations may be pursued.[41] Institutional investors, such as pension fund managers, corporate treasurers, financial institutions, bond dealers, or mortgage bankers, can all use futures contracts to protect themselves.[42] Suppose, for example, that a pension fund manager knows that a substantial sum of money will become available in three months and believes that interest rates will decline before the money is available. The manager would go "long," that is, contract to buy interest rate futures.[43] By selling the appreciated futures at the same time funds are obtained, the additional profit from the futures contracts can be invested so that the effective yield has been protected. Any "loss" due to a decline in interest rates in the cash market before the money becomes available will be offset by profits from the futures transaction.

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[34] Merrill, Lynch, Pierce, Fenner & Smith, Inc., *supra* note 30, at 1.

[35] *Using IOU's to Fight Inflation*, Bus. Week, Oct. 16, 1978, at 88 (Statement of Arthur Burns).

[36] *Id.*

[37] *Why Companies Shy From Equity Issues*, Bus. Week, Oct. 16, 1978, at 96.

[38] Chicago Mercantile Exchange, *supra* note 5, at 4.

[39] *Id.*

[40] *See* note 28 *supra*.

[41] Merrill, Lynch, Pierce, Fenner & Smith, Inc., *supra* note 30, at 1.

[42] Chicago Mercantile Exchange, *supra* note 5, at 13-14.

2. *Treasury Bill Futures*

The Treasury Bill is a short-term debt obligation of the United States Government.[44] The Bills are sold at Federal Reserve auctions each week; they mature in three months and come in denominations of $10,000 to $1,000,000.[45] Treasury Bills are the primary means by which the Treasury of the United States finances the short-term cash needs of the federal government.[46] Through purchase and sale of these and other government securities with checks written on the Federal Reserve Bank, open market operations on the secondary market regulate the money supply of the United States.[47] Due to the great volume of Bills in existence, they are extremely liquid, and it is the widespread acceptance of these bills that renders them an important tool of monetary policy.[48]

In addition to their liquidity, another important quality of Treasury Bills is their security: "As direct obligations of the U.S. government, T-bills are among the lowest risk investments in the world."[49] These characteristics have led many to rely on the movement of Treasury Bills as a barometer of interest rates, and indeed of economic conditions in the country generally.[50] Treasury Bill futures thus enjoy a dominant position in the interest rate futures markets. The volume, security, and general credibility of the underlying bills makes the Treasury Bill future an extremely active and important investment item.[51]

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[43] If interest rates fall before funds are available, the yield available in the securities marketplace will drop. As yields drop, however, interest rate futures go up.

[44] *See* Duobek & Bradt, *Understanding the U.S. Treasury Bill Futures Market* 1 (1976).

[45] *Id.*

[46] H. HUTCHINSON, MONEY, BANKING, AND THE UNITED STATES ECONOMY 101 (1975).

[47] *Id.* at 105-53.

[48] Bills are used primarily by the Treasury for managing its cash position. Tax receipts and the government's expenditures do not occur simultaneously, so the Treasury's cash balance is subject to wide swings. . . .

The Treasury bill market is a highly developed one. Because these securities are direct obligations of the government, they are largely regarded as credit "risk free." This quality in combination with the enormous amount of them outstanding means trading is active. An investor wishing to sell bills rarely has difficulty finding a buyer. Thus, bills are a very liquid investment.

Duobek & Bradt, *supra* note 44, at 1-2.

[49] Chicago Mercantile Exchange, *supra* note 5, at 4.

B. CURRENT TAX LAW

1. *The Capital Gain-Ordinary Income Distinction*

Congress has long realized the need to treat the income generated by different types of assets or activities in significantly different fashions.[52] Capital gain items are, when held for sufficient lengths of time, accorded preferential tax treatment; capital losses are of limited deductability.[53] Unfortunately, "the legislative approach has not been the product of a clear or consistent underlying policy . . . ."[54]

There are essentially three reasons for treating capital gains items favorably in relation to ordinary income items.[55] The first is the so-called "bunching" or "telescoping" concept.[56] Because the appreciation of an asset, such as a painting, occurs over a period of time, taxing the seller on the entire accumulated gain when the asset is sold extracts too high a penalty, given the progressivity of tax rates.[57] In addition, some part of the gain will be due to inflation. A second justification for a reduced tax burden on some classes of assets is the need for stimulation of investment[58]—a fiscal policy consideration. The third reason is to keep investment funds mobile in order to encourage the "highest valued use" of funds.[59] If high taxes are paid on sale of assets, the burden would encourage holding these assets past the optimum time.[60]

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[50] *Id.* at 5.

[51] Dashek & Bradt, *supra* note 44, at 1-2.

[52] *See generally* Surrey, *Definitional Problems in Capital Gains Taxation*, 69 HARV. L. REV. 985 (1956); Note, *The Troubled Distinction Between Capital Gain and Ordinary Income*, 73 YALE L.J. 693 (1964).

[53] I.R.C. §§ 1202, 1211.

[54] 3B J. MERTENS, THE LAW OF FEDERAL INCOME TAXATION §22.01, at 7 (1974).

[55] Note, *supra* note 52, at 695.

[56] *Id.* at 696.

[57] The Supreme Court first considered these rationales in Burnet v. Harmel, 287 U.S. 103, 106 (1932), when it said that the purpose of capital gains treatment is "to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions."

[58] Note, *supra* note 52, at 697.

[59] *Id.* at 698.

[60] *Id.* at 698; *see* Chalnow, *Capital Gains: Should the Holding Period Be Extended?*, 113 TRUSTS & EST. 196, 198 (1974).

Capital asset classification comes from the Internal Revenue Code.[61] The section defining capital assets operates by exclusion, defining certain categories of property as ordinary income items and according the sale of all other property capital gains status.[62] Thus, when one sells an asset that is inventory held for sale to customers, an item defined in the Internal Revenue Code as ordinary income, the gain is taxed as ordinary income.[63] However, if an investor sells securities, which are not within any of the exclusions of section 1221, the funds realized would get capital gains treatment.[64]

2. *Taxation of Treasury Bills*

Treasury Bills are defined as ordinary income items in section 1221 (5). This section has a rather checkered history. Its predecessor was originally enacted as part of the Revenue Act of 1941.[65] The House version of this bill would have treated the interest on Treasury Bills as ordinary income if the bills were held to maturity.[66] If a bill is sold before maturity, however, some part of the price received will reflect the interest accrued to that date. If the prevailing rate of interest in the economy has changed, the bill will be worth correspondingly more or less than the nominal rate. For example, if the prevailing interest rate drops, the return from an outstanding bond with a higher interest rate will become more attractive, and the price one must pay to acquire such an asset will rise. This increase in price is a capital gain component—a gain realized from appreciation in value of an asset disposed of in a sale.[67] This is indeed the general treatment of such obligations in the tax structure,[68] and the House version of the Revenue Act of 1941 would have required such an apportioning between the income (interest) component and the speculative capital gain component.[69] The Senate Finance Committee, however, felt that this computation would be "burdensome"[70] to the taxpayer and proposed the ordinary income treatment now given to Treasury Bills.[71]

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[61] I.R.C. § 1221.

[62] *See, e.g.*, Storrer & Wilson, *What Determines Whether Property Will Qualify As A Capital Asset For Tax Purposes?*, 16 Tax for Accountants 140 (1976); Surrey, *supra* note 52, at 987; Note, *supra* note 52, at 693.

[63] I.R.C. § 1221; Surrey, *supra* note 52, at 988.

[64] Note, *supra* note 52, at 693-94.

[65] Revenue Act of 1941, Pub. L. No. 77-250, § 115(b), 55 Stat. 687 (amending § 117(a)(1) of the Internal Revenue Code of 1938, predecessor to § 1221 of the Internal Revenue Code of 1954).

[66] *See* S. Rep. No. 673, 77th Cong., 1st Sess. 30 (1941).

[67] *See* Zafft, *Discount Bonds—Ordinary Income or Capital Gains?*, 11 Tax L. Rev. 51, 58-59 (1955).

[68] I.R.C. § 1232.

[69] S. Rep. No. 673, *supra* note 66, at 30.

3. *Taxation of Futures*

When an investor purchases a commodity futures contract, he purchases a contract right—a future commitment obligating him to buy or sell a fixed amount of a substance at a set price at a future date.[72] This does not, however, end the analysis. Contract rights may get either capital or ordinary income treatment.[73] Particularly with futures and option contracts, the tax treatment seems to stem from two separable modes of analysis, that are not always clearly delineated, but which generate identical results under ideal circumstances. It is in the case when circumstances are not ideal that problems arise.

a. *Activity analysis*: The analysis of futures transactions in Revenue Ruling 78-414 is the more traditional one, focusing on the activity of the investor with respect to the trading of futures contracts themselves. Thus, the opinion begins its treatment of the tax law of futures with a discussion of *United States v. New York Coffee & Sugar Exchange*,[74] which is often cited for the proposition that those who trade commodity futures can be divided into three types: hedgers,[75] investors,[76] and gamblers.[77]

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[70] The "burden" placed on taxpayers would be that of computing what portion of gain or loss on the sale of a Bill represented accrued interest and what portion represented capital gain or loss.

[71] S. Rep. No. 673, *supra* note 66, at 30-31.

There seems to be a prejudice against some types of speculative activity that underlies short-term capital gain treatment. One does not obtain the benefit of reduced tax rates, but must face the burden of limited deductibility. The reluctance to apply short-term capital gain rates to Treasury Bills may stem from a feeling that investors in the most substantial, though short-term, of government debt obligations do not deserve the onus of short-term capital gain treatment.

[72] Rev. Rul. 78-414, 1978-2 C.B. 214.

[73] *See* notes 91-92 *infra*.

[74] 263 U.S. 611 (1942). *See generally* 2B J. Mertens, *supra* note 54, § 22.15, at 113-33.

[75] Hedging may be thought of as the shifting of risk by those who either supply or demand a product. *See* notes 9, 47 *supra*. "Potential hedgers in interest-rate futures include banks, corporations, nonbank financial institutions, government securities dealers, trust departments, mutual funds, pension funds, real estate investment trusts, and finance companies." Chicago Mercantile Exchange, *supra* note 13, at 13, 14.

[76] Investors assume the risks of unfavorable price changes in hopes of profiting from favorable ones. *See* notes 50-51 and accompanying text *supra*.

[77] Gamblers are said to be irresponsible risk takers; presumably their losses are deductible only to the extent of their gains. This category is of limited significance, however, because there is a presumption against such a holding. Commissioner v. Covington, 120 F.2d 768, 771 (5th Cir. 1941) (Holmes, J., concurring).

The activities of hedgers generate ordinary income or loss.[78] Thus, losses of hedgers are fully deductible while profits are taxed at ordinary rates.[79] On the other hand, investors get capital asset treatment, with its favorable treatment for long-term gains and limited deductibility of losses.[80]

The category of hedgers extends, by judicial implication, the list of those accorded ordinary income treatment for the sale of property under section 1221.[81] The principle underlying this extension was demonstrated in the landmark decision of *Corn Products Refining v. Commissioner*,[82] which is aptly summarized by Revenue Ruling 78-414:

> The taxpayer purchased corn futures in order to protect itself against an increase in the price of corn, its major raw material. Both the Tax Court [[1952] 11 Tax Ct. Mem. Dec. (CCH) 721] and the Court of Appeals [215 F.2d 513 (2d Cir. 1954)] found that the futures transactions were an integral part of its business . . . . The Supreme Court held that since Congress intended profits and losses arising from the everyday operation of a business be considered ordinary income or loss rather than capital gain or loss, any gains or losses the taxpayer sustained in its futures transactions were ordinary gains or losses.[83]

Consider the importance of this extension. Under ordinary principles of construction, the taxpayer was outside the treatment of section 1221. Strictly read, only one holding inventory for sale to customers in the form of futures contracts, or a dealer in futures, would get ordinary income treatment for futures trading; all others would obtain capital gain or loss. The Court found the activity of the trader to be an integral part of its business, however, and thus the sort of activity which generates ordinary income.[84] On the other hand, the fact situation posited in Revenue Ruling 78-414 is explicitly about a nonhedger; the taxpayer is an investor with regard to the futures, one who in any other futures market would get capital gain treatment.[85]

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[78] Rev. Rul. 72-179, 1972-1 C.B. 57.

[79] *See* I.R.C. § 64.

[80] *See* I.R.C. §§ 1201, 1222.

[81] *See* Note, *supra* 52, at 695.

[82] 350 U.S. 46, *rehearing denied*, 350 U.S. 943 (1955).

[83] Rev. Rul. 78-414, 1978-2 C.B. 214.

[84] 350 U.S. at 53, Rev. Rul. 78-414, 1978-2 C.B. 214.

[85] Rev. Rul. 78-414, 1978-2 C.B. 214.

The Ruling sums up its analysis of the case of the investor in Treasury Bill futures in one paragraph:

> Thus, the purchase of the commodity future contract for future delivery of Treasury bills as described above is the acquisition of *rights* to Treasury bills and not the acquisition of Treasury bills. Since *A* (the taxpayer) did not hold the commodity future contract primarily for sale to customers in the ordinary course of *A*'s trade or business or purchase the contract as a "hedge," the commodity future contract is a capital asset in *A*'s hands. The fact that Treasury bills, pursuant to section 1221 (5) of the Code, are not capital assets does not affect the conclusion that the above commodity future contract on Treasury bills is a capital asset. Accordingly, the gain realized by *A* on the sale of the commodity future contract is long-term capital gain.[86]

The operative language may be broken down into the following proposition: There are two, and only two, possible ways in which trading activity in any commodity futures contract *may* generate ordinary income: hedging,[87] and holding the contracts as inventory to sell to customers.[88] In the hypothetical case given in Revenue Ruling 78-414, the taxpayer fell into neither category and, therefore, was given capital asset treatment.

Based solely on the activity of trading futures contracts, the analysis is entirely correct. The investor in Treasury Bill futures is speculating, hoping to make or lose money based on changes of the interest rate, which is classic capital-gains type behavior, and should be treated as such.

b. *Underlying asset approach*: Notwithstanding the above-stated analysis, the results of the Revenue Ruling are demonstrably wrong.[89] There is a third strand to the case law and tax code granting ordinary income treatment to futures, and, more particularly option contracts, based on the character of the asset underlying the future (or option).

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[86] *Id.* (emphasis in original).

[87] *Id.* Hedgers would be corporate treasurers, pension funds, etc. *See* note 75 *supra*.

[88] Rev. Rul. 78-414, 1978-2 C.B. 214. *But see* George R. Kemon, 16 T.C. 1026 (1951). An interesting analytical problem is presented—how can dealers, who get ordinary income treatment, be distinguished from investors, who get capital gain. Certainly it cannot be the amount, or even the sophistication of labor input, for many investors devote a great deal of "work" to their activities. The distinguishing factor seems to be the way in which profits are made—investors rely on the appreciation of assets or investments to make profits, while dealers rely on markup and are willing at any time to buy at one price and sell at a higher one.

[89] *See* notes 97-134 and accompanying text *infra*.

The fact that these are contract rights, as noted above, does not end the analysis: "Just what property rights qualify for capital gains treatment and what property rights do not so qualify appears to be a close and difficult question."[90]

Where the sums received by the taxpayer represent substitutes for future income, the present sums are usually treated as income rather than capital gain.[91] The appreciation (or loss) from the change of price of the Treasury Bill is ordinary income to the taxpayer by statutory definition.[92] Based on this analysis, the right to receive these funds through the present fluctuations of a futures contract would also seem to be ordinary income.

Some commentators have been skeptical as to the helpfulness of this analysis in determining close cases. Based solely on the analysis of the case law, the income from a Treasury Bill future is not a substitute for a future income stream from the Treasury Bill. Rather, any income from the future is generated by anticipated changes in the value of the income stream of the bill, not the bill itself. Thus, without looking further, the courts might have held the income from a Treasury Bill future to be speculative, and thus a capital gains item. This analysis would appear to be sound based solely on the nature of the future as an asset. Yet, what of the general rule?

Again, the Internal Revenue Code states as a general proposition that:

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[90] Turzillo v. Commissioner, 346 F.2d 884, 888 (6th Cir. 1965).

[91] *See, e.g.*, Norton v. United States, 551 F.2d 821 (Ct. Cl. 1977), *cert. denied*, 434 U.S. 831 (1977).

> The approaches [for determining the tax status of contract rights] may be grouped into certain broad categories: (1) Is the asset "property" which is a "capital asset" under § 1221? *See Comm'r v. Gillette Motor Transport Co.*, 364 U.S. 130, 80 S. Ct. 1497, 4 L. Ed.2d 1617 (1960); *Comm'r v. Ferrer*, [304 F.2d 125 (2d Cir. 1962)]. (2) Do the amounts received by the taxpayer upon the sale of the contract rights represent a substitute for future ordinary income that would otherwise have been received by the taxpayer? *See Comm'r v. P.G. Lake Inc.*, 356 U.S. 260, 78 S. Ct. 691, 2 L. Ed.2d 743 (1958); *Comm'r v. Ferrer, supra.*

Id. at 826 n.17.

Note that in Commissioner v. Ferrer, 304 F.2d 125 (2d Cir. 1962), payments for release of rights in a play were divided—those which represented substitution for foregone income were accorded ordinary income treatment (the contingent royalty interest), while the taxpayer's right to restrict the author of a play in transferring retained film rights and taxpayer's leasehold interest in the play were held to be capital assets. *See* Eustice, *Contract Rights, Capital Gain and Assignment of Income—The Ferrer Case*, 20 TAX L. REV. 1 (1964). Justice Friendly's line of inquiry in *Ferrer*, particularly with respect to payments for rights to future income, has not been completely successful. "In some respects one tends to feel more confused (after reading the opinion), but one's confusion is on a higher level and about more important things." *Id.* at 76.

[92] I.R.C. § 1221(5).

> Gain or loss attributable to the sale or exchange of, or loss attributable to failure to exercise, an option to buy or sell property shall be considered gain or loss from the sale or exchange of property which has the same character as the property to which the option relates has in the hands of the taxpayer (or would have in the hands of the taxpayer if acquired by him).[93]

Strictly speaking, of course, a commodity future contract is not an option. An option contract is enforceable only against the grantor; if the grantee is inactive, the option will lapse and go out of existence. A futures contract would not operate in the intended manner if it could be allowed to lapse by one of the parties because in a futures contract, one party agrees to accept, and the other party to deliver, specified quantities of goods at agreed-upon prices and dates, thus shifting the risk of loss in the event of price changes. Therefore, if a party to a futures contract holds until the date of delivery, they will be called upon to deliver or accept delivery of their commodity.[94]

Why, then, should a general rule or principle of tax law—that option or futures contracts should be taxed as would the underlying asset in the hands of the investor—find application here? It has been shown that the case law that has been generated regarding other types of contractual assets is not greatly clarified by such a rule (where one often cannot tell whether the underlying asset is income or capital in nature). Moreover, with regards to the Internal Revenue Code, it is arguable that Congress intended capital gain treatment for all grantors of options in speculative type goods.[95]

The answer can be simply stated: Unlike other contractual assets, futures contracts and options have a close, binding relation to the underlying asset. Every investor in futures or options has the possibility open to him of accepting delivery of the underlying asset. The Supreme Court realized the importance of this when it decided *Corn Products*. The Court noted:

> The hedger may either sell the future and purchase in the spot market or take delivery under the future contract itself. But if a sale of the future created a capital transaction while delivery of the commodity under the same future did not, a loophole in the statute would be created and the purposes of Congress frustrated.[96]

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[93] I.R.C. § 1234(a).

[94] Delivery of actual commodities is covered under the rules of the exchanges. *See* G. Gold, *supra* note 24, at 36-40.

[95] *See* text accompanying notes 91-93 *supra*.

[96] 350 U.S. at 51.

C. The Effect of Revenue Ruling 78-414

Revenue Ruling 78-414 accomplishes precisely what the Supreme Court feared in *Corn Products*: it holds a contract for Treasury Bill futures to be a capital asset, while the underlying asset remains statutorily defined as an ordinary income item.[97] In essence, an investor is given a tax election when investing in Treasury Bill futures under the ruling. If the transaction has been profitable, the investor will close out the futures contract before delivery,[98] and under the Ruling, get lower-taxed capital gain treatment.[99] If the transaction shows a loss, the investor can take delivery on the futures contract and sell the Treasury Bills on the open market.[100] In such a case, the loss would be incurred on the sale of the Treasury Bills, rather than on the futures contract, and presumably the taxpayer would get a fully deductible ordinary loss.[101]

Suppose, for example, that an investor has an outstanding profit in Treasury Bill futures. To secure the benefits of capital gain treatment for his profit, he need only sell the future before it comes due, reporting capital gain on his return under Revenue Ruling 78-414. On the other hand, suppose he has an outstanding unrealized loss. The taxpayer need not face the burden of capital loss on the very same contract. When the futures contract comes due, he will be obligated (if, for example, his loss is in a long position) to accept delivery of Treasury Bills in the amount of $1 million for every contract he held, the bills to be purchased by the party on the other side of the futures transaction. He obligated himself, however, to buy them at a price above the current market price. He does not realize his loss when he accepts the bills at this higher price, but he does realize it when he sells them at the lower market price. Thus, our taxpayer, by taking delivery when he had a losing contract, incurs his loss not in satisfaction of his futures contract obligation, but in a spot-market sale of the Treasury Bills themselves, which are ordinary income items.

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[97] Rev. Rul. 78-414, 1978-2 C.B. 213.

[98] To close out a long position, the investor writes a contract to sell a short in the same commodity, same month, and same market—the two transactions cancel out. *See* G. Gold, *supra* note 24, at 6.

[99] Rev. Rul. 78-414, 1978-2 C.B. 213.

[100] Each futures contract is for $1 million worth of Treasury Bills. Although this is a large amount, the investor should find little difficulty in financing the transaction because the funds sought by the taxpayer are to be used to purchase one of the most secure investments available, and they will be held only long enough to place them on the market (assuming that the investor is accepting delivery under a long position—closing a short position would involve the same sort of transaction, with the taxpayer borrowing funds, purchasing the Bills, and delivering them for the contract price).

[101] Section 1221(5) defines short-term debt obligations of the United States government (*i.e.*, Treasury Bills) to be ordinary income items from which the loss should be fully deductible under § 64.

This is clearly the perverse result that the Supreme Court had foreseen in *Corn Products*. If the taxpayer is truly engaged in capital gains activity, he should not be able to choose to take his losses as ordinary income.

On the other hand, if the IRS had chosen the opposite position, the result would be equally perverse. A ruling to the effect that Treasury Bill futures generate ordinary income would have at least two major potential objections facing it. First, the entire theory that capital gains and ordinary income have something to do with different types of activity or assets[102] would be seriously impaired because an activity which is clearly speculative in nature (investing in Treasury Bill futures) would be treated as if it generated ordinary income. Second, one type of commodity future would generate ordinary income while other types, which rise and fall in a closely related manner (*e.g.*, interest rate futures, gold, silver), generate capital gains. This opens the way for the transformation of ordinary income into capital gain.

For example, a hypothetical investor wishes to convert a given amount of ordinary income into capital gain.[103] If Treasury Bill futures were taxed as ordinary income items, the investor could proceed as follows. The investor hypothesizes that interest rates are about to decline. He takes a short position[104] in Treasury Bill futures and a conflicting position in another interest rate future, for example, commercial paper.[105] When the anticipated interest rate change occurs, the Treasury Bill transaction will be closed out for a loss and the commercial paper transaction will show a corresponding profit. If the loss in Treasury Bill futures is treated as ordinary, it can offset the taxpayer's income for the year,[106] while the profit on commercial paper futures will be taxed as capital gain, resulting in a tax saving of sixty-six percent.[107]

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[102] *See* notes 52-62 *supra*.

[103] For another sample transaction, see *Futures & Taxes*, COMMODITIES, Oct. 1978, 27, 31.

[104] Dushek & Bradt, *supra* note 4[illegible] at 4.

[105] In going "long," one contractually obligates himself to accept delivery of a specified quantity of a commodity at a stated future date and price. Going "short" is the reverse—one is obligated to deliver the commodity. When the futures price goes up, those with long positions may sell them for a profit; those with short positions are faced with a loss when they terminate their position. *See generally* G. GOLD, *supra* note 22, at 17; Kennedy, *Selecting the Off-Beat Investments: Puts, Calls, Straddles, Warrants, Commodity Futures and Other Exotica*, 32 N.Y.U. TAX INST. 1093, 1112 (1974).

[106] I.R.C. § 62(4).

To prevent this result, Revenue Ruling 78-414 declares the profit or loss to the investor in our hypothetical Treasury Bill future transaction to be capital gain or loss.[108] The transmutation scheme just mapped out depends on Treasury Bills and all other interest rate futures being treated differently for tax purposes even though they respond to the same market forces affecting interest rates generally. Thus, if Treasury Bills got ordinary income treatment, a general change in market conditions can be used to create a loss that is set against items of ordinary income even though the same general change in market conditions is used to create an equivalent profit in other interest rate futures that will be taxed as capital gain. If all futures that respond to similar market forces (either substitutes or complementary goods) are taxed identically, then the scheme above is ineffective. Capital losses can be used to offset ordinary income only to a limited extent[109]—thus, although the taxpayer can create balanced gains and losses in the futures market, the losses cannot be used to reduce his ordinary tax burden.

A second major problem with this portion of the Ruling is that option contracts are not dealt with; presumably, the general rule of the Internal Revenue Code dealing with options would dictate ordinary income treatment for the option in this situation[110] so that the hypothetical transaction above could still take place. Just as interest rate futures should tend to move together, options on interest bearing obligations should respond to the same stimuli. The taxpayer would attempt to create a loss in the option, and obtain ordinary treatment, while an offsetting or balanced position in an interest rate future would render a capital gain.[111]

II. COMMODITY FUTURES SPREADS AND REVENUE RULING 77-185

Straddles, or spreads, are simultaneous holdings of short and long positions of commodity futures in different delivery months that may be held for the purpose of postponing the taxation of income.[112]

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[107] *Id.* § 1201.

[108] Rev. Rul. 78-414, 1978-2 C.B. 213.

[109] I.R.C. § 1211. *But see id.* § 1212 (allowing carrybacks and carryforwards of capital loss).

[110] Section 1234 states the general rule that options are to be taxed in the same manner as if the underlying property had been acquired by the taxpayer. *See also* notes 90-102 *supra*.

[111] As with the hypothetical futures transaction, the investor must first forecast a position that will create a loss in the option contracts as written, while a capital gain is created as before in the commercial paper future. For purposes of this type of transaction, it does not matter that one contract is an option and the other a future, as they both respond to the same stimuli.

Recall that transmutation relied on the assumption that all interest rate futures move in response to the same general changes of the prevailing interest rate.[113] The postponement technique relies on a similar assumption: that contracts for the same commodity with different delivery dates move in the same direction.[114] Based on this assumption, the taxpayer takes a short position in one far-off month, and a long position in a different month. When the price of the contracts changes, he hopes to make a profit on one "leg" of his spread, and a corresponding loss on the other.[115] Late in the tax year, the investor realizes his loss by cancelling his losing positions, completing the first phase of the spread. The taxpayer now has a loss to set against current profits, lowering this year's tax burden. He wishes to postpone "taking" his profit until the next tax year. In order to "lock in" this profit, protecting it against adverse price changes that could occur before he can safely sell in January, the taxpayer takes a new position opposite to the one in which he currently has his profit in a third distant contract month[116] when he closes out his loss leg in December.[117] Thus, if the price moves adversely and his profitable position deteriorates, he could recapture the profits in the opposite position—the new leg. The taxpayer maintains this balanced position until the new tax year arrives, at which time he closes both legs, realizing his profit in the new year.

To summarize, a movement in the price of the underlying commodity generated a profit on one futures contract and a corresponding loss on the opposite, balancing contract position. The taxpayer takes the loss in year one, rolls into a balancing position to protect his profit, and lets the profit ride into year two.

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[112] Goldfein & Hochberg, *Use of Commodity Straddles Can Effect Impressive Tax Saving*, 29 J. TAX. 342 (1968).

[113] *See* text accompanying note 6 *supra*.

[114] *See* Dushek & Bradt, *supra* note 44, at 11.

[115] For another sample transaction, see Selig & Schmittberger, *Tax Aspects of Commodity Futures Trading*, 6 HOFSTRA L. REV. 93, 101 (1978).

[116] The taxpayer must trade in different months to avoid cancelling himself out of his balanced positions.

[117] The following example illustrates the lock-in effect. As of December, taxpayer has a profitable long position in June futures and a losing short in March (which implies a general price increase in the underlying commodity). Taxpayer takes his loss by buying March contracts to cover his short position; simultaneously, he takes a new short position in September futures. Thus, if in January (the new tax year) the price of the underlying commodity has fallen and the profitable long position has deteriorated, the September short position will show a profit—if the price had gone up, however, the extra profit generated by the long position is foregone because the short position would begin generating losses. If the movements of the different months are perfectly correlated, the amount of loss declared in December and the profit taken in January will be equal.

> Straddle transactions offer opportunity for profit and risk of loss because of the widening or narrowing of the spreads between the straddle months. While an investor who takes a long or short futures position seeks to profit by absolute price fluctuations, an investor who effects a straddle seeks to profit by changes in price differences. A straddle investor may not care whether the price of a given commodity increases or decreases. His concern is the direction in which price differences change.[118]

There are essentially two explanations for the intermonth differential that exists in futures generally. One is supply conditions, including harvest times for perishable crops, anticipated labor shortages, or seasonal changes in the money supply for interest rate futures. The other is a sort of fixed cost component which reflects carrying charges, storage, interest, and insurance for storable commodities.

Many traders do enter the market to make a profit based on what they hope is a general misperception of the correct intermonth variation,[119] but other traders might enter the market with "large short-term gains in a year when his ordinary income tax bracket is high [and] may wish, through a commodity straddle, to postpone taxation of these gains to the following year."[120]

In executing a tax-avoidance straddle, the trader hopes that the intermonth spread (in contrast to the hopes of an arbitrage trader) will stay roughly constant. In this way, a general price movement will create correspondingly equal gain and loss in his balanced (long and short) positions.[121]

In addressing the question of deductibility of losses arising from straddles involving silver futures, the IRS has taken the position in Revenue Ruling 77-185[122] that if the transaction is entered into without a reasonable expectation of profit and for no economic purposes other than tax avoidance, then the deduction will be disallowed.[123] The effect of this Ruling is to carry forward the loss to be set off against the profit when the transaction is closed.[124] The IRS points out that when a taxpayer sells a futures contract at a loss and immediately purchases another contract to maintain a balanced position and insure equal profits and losses, there is no real economic change occurring except for the fact that the new position has a different delivery date. In allowing the substance rather than the form of the transaction to govern its treatment, the IRS concludes that all losses incurred in such tax-avoidance straddles shall be disallowed.[125]

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[118] Selig & Schmittberger, *supra* note 115, at 98-99.

[119] *See id.* at 98-99.

[120] Goldfein & Hochberg, *supra* note 112, at 342.

[121] *See* notes 115-17 *supra*.

[122] Rev. Rul. 77-185, 1977-1 C.B. 49.

[123] *Id.* at 50.

[124] Selig & Schmittberger, *supra* note 115, at 102.

In an excellent summary of the treatment of tax straddles prior to Revenue Ruling 77-185, Laurence Goldfein and Lester Hochberg noted that if the wash sale rule[126] of section 1091 of the Internal Revenue Code were applied to commodity futures contracts requiring delivery in different months, the tax benefits of the straddle "would be seriously impaired."[127] In order for the wash sale provisions to apply, a futures contract would have to be considered a "security" and a futures contract requiring delivery in one month would have to be considered "substantially identical" to a contract requiring delivery in a different month.[128] Although the courts have split on the question, the authors point out that the Tax Court has followed the approach of the Second Circuit in holding that the wash sale provisions do not apply when the transaction involves commodity futures with different delivery dates.[129] Similarly, for purposes of the short sale rule,[130] the Internal Revenue Code provides that commodity futures requiring delivery in different months are not "substantially identical," and thus not subject to the short sale rule.[131]

Goldfein and Hochberg hypothesize that *Goldstein v. Commissioner*,[132] which disallowed deductions for loans made to purchase bonds, might be applied to tax avoidance straddles. They analyze the situation in an amazingly accurate predictive manner:

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[125] Rev. Rul. 77-185, 1977 C.B. 49, 50.

[126] The wash sale provisions of section 1091 disallow losses on sales of stock or securities if within 30 days prior to or after the sale the taxpayer acquires "substantially identical" stock or securities. The disqualified loss is not rendered incapable of deduction because § 1091 allows the loss to be added to the basis of the stock or security purchased to be recognized upon its subsequent sale or disposition. Commodity futures have been held to be outside these provisions. *See Goldfein & Hochberg*, *supra* note 114, at 343-44.

[127] *See id.* at 344.

[128] *Id.*

[129] *Id.*

[130] The short sale provisions of section 1223(b) prevent the conversion of short-term capital gain to long-term capital gain and the creation of artificial losses. *See* Goldfein & Hochberg, *supra* note 112, at 344. In order for the section to apply, the taxpayer must hold substantially identical property for six months or less on the date of the short sale, or acquire the property on or before the closing date of the short sale.

[131] I.R.C. § 1233(e)(2)(B).

[132] 364 F.2d 734 (2d Cir. 1966).

> If the rationale of the *Goldstein* case were applied to the commodity straddle, the short term loss in the earlier year . . . would be disallowed and presumably an adjustment in basis for the retained property, similar to that under the wash sale rules, would be provided so that the taxpayer would not be required to recognize gain to the extent of the loss previously disallowed.
>
> However, it would seem that the doctrine of the *Goldstein* case should not be a bar to the use of a commodity straddle. Contrary to the situation in *Goldstein*, it cannot be said that the transaction objectively holds out no prospect of appreciation sufficient to counter the expenses of the transaction. Moreover, straddles are often entered into with mixed motives of tax deferral and the expectation of deriving an economic profit.[133]

In Revenue Ruling 77-185, the IRS created what amounts to an administrative wash sale rule.[134] The IRS held that a sample silver spread "taxpayer was in exactly the same balanced position . . . thus, the . . . sale resulted in no real change of position in a true economic sense and does not represent a closed and completed transaction."[135] The Ruling went on to point out that the taxpayer's dominant purpose was tax avoidance, and that he had no "reasonable expectation" of deriving an economic profit.[136]

The questionable use of precedent, hasty analysis, and difficulty of administration of this Ruling has been ably pointed out by Goldfein and Hochberg,[137] and others.[138] The IRS, by tacking on the final paragraph of Revenue Ruling 78-414, which amplified Revenue Ruling 77-185, is obviously announcing that it intends to abide by its previous ruling. There are, however, some very well-reasoned contrary opinions, particularly concerning the application of the standard. Whenever a rule of tax law is based upon an examination of the motives or purposes of the taxpayer, considerable confusion arises as to the proper showings that must be made. What must be established in order to defeat the chosen standard, whether it be any nontax motive, or a reasonable expectation of profit, would seem to be left "to the ingenuity of counsel, who no doubt will be litigating these cases if the IRS continues its position in Revenue Ruling 77-185."[139]

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[133] Goldfein & Hochberg, *supra* note 112, at 345 (emphasis in original).

[134] Goldfein & Hochberg, *An Analysis of IRS Ruling That Straddle Transactions Lack Requisite Profit Motive*, 47 J. Tax. 142, 145 (1977).

[135] Rev. Rul. 77-185, 1977-1 C.B. 49.

[136] *Id.*

[137] Goldfein & Hochberg, *supra* note 134.

[138] Selig & Schmittberger, *supra* note 115.

III. PROPOSALS

A. THE ELIMINATION OF SECTION 1221(5)

As has been noted, it is still possible after Revenue Ruling 78-414 to transmutate ordinary income into capital gain through the use of Treasury Bill options.[140] In addition, the taxpayer is now allowed to elect whether his futures will be taxed at capital or ordinary rates by choosing whether or not to allow the future to expire.[141] At the same time, it has been demonstrated that the alternative of treating Treasury Bill futures as ordinary income items would be unacceptable.[142]

The source of the problem lies not in the futures, but in the tax treatment of the underlying commodity.[143] The provision of the Internal Revenue Code designating gains from Treasury Bills as ordinary income items is irrational, apparently based solely on an administrative convenience theory. The interest component of the Treasury Bill is an ordinary income item. If the bill is held to maturity and redeemed, this will be the sole incidence of taxation. If the bill is sold on the secondary market before maturity, however, the taxpayer may receive either more or less than the value of the interest accrued to the date of sale. If interest rates in the market have risen to $x + 1$, for example, the rational investor will not pay face value for an instrument yielding only x; rather, he will pay a lesser amount such that the yield of the two instruments will be the same. It is this component, the change in value of the bill due to changed interest rate conditions after sale, that represents either an appreciation or depreciation in the value of the property rights to receive the sum of money due at the redemption of the bill. This is a capital gain component—the tax law should recognize it as such.

When Treasury Bill options and futures did not exist, the problem was trivial. Treasury Bills are of such short duration that long-term holding periods could not be reached. Thus, the taxpayer would never get the benefit of reduced capital gains tax rates, only the burden of limited deductibility of losses. The tax law ignored the substantive theory behind the capital gain/ordinary income distinction in what was then considered to be a trivial case. But with the advent of trading in futures and options, the situation can no longer be considered trivial. The whole profit from a future or option contract on Treasury Bill futures is speculative in nature because the prices of such options and futures only change to reflect generally unanticipated price changes that may arise. Thus, the entire gain or loss is capital in nature.

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[139] Goldfein & Hochberg, *supra* note 134, at 146.

[140] *See* text accompanying notes 98-101, 110-11 *supra*.

[141] *See* text accompanying notes 97-98 *supra*.

[142] *See* text accompanying notes 102-07 *supra*.

[143] *See* text accompanying notes 65-71 *supra*.

The elimination of section 1221(5) from the Internal Revenue Code would have the following effects. Treasury Bills would fall under the general section on such items of indebtedness,[144] which requires that gain and loss on sale before maturity be apportioned to reflect interest and capital gain components. This would sacrifice the administrative convenience alluded to in the legislative history. This is of dubious significance, however, due to the added problems caused by the advent of a futures market for Treasury Bills. Speculative gains on Treasury Bills would be treated as capital, and thus, the two approaches of the tax law with respect to futures and options—the activity analysis and the underlying asset concept—would be in harmony. The underlying asset concept would indicate that the gain on the asset itself would be capital; thus, the profit on the future should be capital as well. This result would hold for a future or an option contract, or for any right to gain from the capital gain component of a Treasury Bill.

Activity analysis as well would dictate capital gain treatment for Treasury Bill futures once section 1221(5) is eliminated. The taxpayer is engaged in a classic sort of capital gain behavior. In hoping for the appreciation of his rights under the futures contract, the investing taxpayer is clearly within the capital gain area. The elimination of section 1211(5) would thus harmonize the tax law, while at the same time end the possibility of transmuting ordinary income into capital gain through futures trading.

B. THE YEAR-END WASH SALE RULE

Although the motive-based standard proposed by the IRS in Revenue Ruling 77-185 and reaffirmed in Revenue Ruling 78-414 may be unworkable, it is true that this test strikes at the very heart of the tax straddle maneuver. When the taxpayer is engaged in such a transaction, the goal is to achieve a riskless transfer of tax burden.[145] The motive of such a taxpayer probably is to avoid tax burdens. Examining only the substance of a complicated transaction without the benefit of telepathic insight, however, is often a difficult method of determining the true motives of the taxpayer.[146] And if the evil to be avoided is the *riskless* postponement of taxes, can the taxpayer execute the transaction sloppily so that some actual profit or loss occurs net of the tax transfer? The result of this transaction would be that the taxpayer could establish profit motive by using the gain or loss as evidence that his funds really were at risk.[147]

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[144] I.R.C. § 1232.

[145] *See* Goldless & Hochberg, *supra* note 112, at 343.

One alternative adopted to prevent similar transaction in other securities is the wash sale rule of section 1091.[148] The IRS, however, has issued several rulings specifically exempting the futures markets from this rule.[149] One of the great fears underlying the nonapplication of the wash sale rule is that arbitrage traders will be eliminated from the market place.[150]

In Revenue Ruling 78-414, the IRS is attempting to forge a rule that will render the benefits of a wash sale rule—preventing tax avoidance—without the chilling effect such a rule would have if applied generally to commodity futures trading. The optimal solution, however, is to avoid motive analysis completely. A mechanical rule that eliminates the benefits gained from tax avoidance without inquiring into the motives of the taxpayer would be self-administering.

Tax benefits accrue to those in a straddle situation because losses are deducted in one tax year while profits are taken the following year. Thus, when a trader attempts to carry an unrealized profit across the end of a year in the form of a balanced position, any attempt to deduct a loss in related futures in the previous year should be disallowed, with the loss carried forward and set against the proceeds from the profit position. This "hard" form of the wash sale rule would operate only when the taxpayer attempts to carry a balanced position across the end of a year. It would eliminate any tax benefit the taxpayer gains during the preceding year without inquiring into the motive of the taxpayer, yet it eliminates only the tax benefits gained through deduction of losses in a year before the declaration of gains by carrying these losses forward. Thus, arbitrage traders who carried a spread across the end of a year would lose only the prospective tax benefit, which should not chill the general arbitrage market.

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[146] *See* Goldfein & Hochberg, *supra* note 134, at 146-47.

[147] *Id.*

[148] *See* note 126 *supra*.

[149] *See* Goldfein & Hochberg, *supra* note 112, at 343-44.

[150] *See* note 119 and accompanying text *supra*.

The only manner in which a determined taxpayer could attempt to elude this rule would be to ride "naked" across the end of the year—to close out his balancing position as close as possible to the end of the year, carry only the profitable position across the year's end, and immediately rebalance the position or take the profit the first day of the new tax year.

The volatility of Treasury Bill futures is quite substantial: the prospect of riding naked for any period of time brings with it the possibility of enormous losses sufficient to discourage all but the boldest of traders. Spot audits of large losses posted in the last trading week of the year would serve as a useful additional check.

CONCLUSION

A flurry of attention in a rather exotic tax avoidance area spawned Revenue Ruling 78-414. It bears many of the earmarks of stopgap analysis: reliance on recent, although controversial, precedent; allusion to general principle; and a failure to deal with a significant underlying problem. The optimal result flows from a clear understanding of all facets of the futures markets, and not from hasty, conclusory rulings.

The results promised by the Ruling are the correct ones: Treasury Bill futures should be capital assets, and riskless spreading of tax burden through commodity futures should be prevented. Revenue Ruling 78-414 is of dubious value as a means toward either goal.

Terence Kane

E. "TRADING IN COMMODITIES," SIMON LEVIN AND CHARLES S. ZUCKER, TAXATION FOR ACCOUNTANTS, VOL. 28, AUGUST, 1979, PP. 94-102

[redacted] Taxation for accountants, v. 23, Aug. 1979: 94-95, 98-102

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Trading in commodities can result in tax savings as well as investment advantages

" *Futures contracts, puts, calls and straddles have become increasingly popular forms of investment. This article explains how each one works and highlights the opportunities they now can offer for tax deferral and for the conversion of ordinary income into capital gain.* "

by **SIMON LEVIN** *and* **CHARLES S. ZUCKER**, *Attorneys, Newark, New Jersey*

IN THE United States, futures contracts are now traded not only on traditional foodstuffs such as corn, wheat and potatoes, but on such "commodities" as silver, gold, plywood, frozen orange juice, live cattle, propane gas, foreign currencies and interest rates (long-term, by such contracts as those on Government National Mortgage Association mortgage certificates, "Ginnie Maes", and short-term, by contracts on Treasury Bills). The futures markets attract not only those commercial users who seek protection from variations in market prices by hedging their production or requirements, but also those who have a speculative interest in profiting from price rises or declines.

Futures contracts

A commodity futures contract is simply a promise to deliver a fixed quantity of a commodity of a stated grade on a specified date. A purchaser of a futures contract agrees to accept delivery; a seller, to make delivery. The contractual obligation need not be satisfied by physical delivery or acceptance of the commodity. In fact, it is estimated that over 95% of the contracts traded are satisfied through termination by making an offsetting sale or purchase of an equivalent commodity futures contract on the same exchange prior to the agreed upon delivery date. The profit or loss for the investor who thus terminates his obligation is measured by the difference between the price at which the initial contract was purchased or sold and the price received or paid for the offsetting sale or purchase, after allowance for brokerage commissions.

The purchaser of a futures contract who does not intend to take physical delivery of the commodity expects that prices will increase and is said to hold a long position. If the investor expects prices to fall, he will sell on the futures market (thus assuming a short position) and later cancel his sale by buying a futures contract for the same quantity and expiration date. Although an initial short sale of a futures contract is a sale of something the investor did not possess, he intended to buy the commodity he was obligated to deliver pursuant to the contract—or its equivalent, the long position—at a later date.

Broadly speaking, there are two types of traders in the commodity futures markets: hedgers and speculators. Hedgers are producers, processors or consumers of physical commodities, *i.e.*, those who are commercially involved, or who deal, in the commodities. By hedging, these commercial interests freeze profit margins or stabilize the value of inventory. The hedger looks to the futures market for insurance, either against depreciation in the value of unsold products if commodity prices fall (a risk insured against by going short in the futures market), or against losses on forward sales if commodity prices rise (here, the insurance takes the form of a long position in the futures market). A hedge is the opening of a futures position opposite to the situation in which the hedger already finds himself. Thus, a producer who has or will have the commodity itself, and therefore can be said to be long in the physical commodity, would open a short futures position; a manufacturer or commercial user who will have to purchase the actual commodity in the future, and therefore can be said to be short in the physical commodity, would open a long position.

To illustrate a short hedge, suppose a farmer will have 50,000 bushels of wheat available for marketing after harvest in July. In order to avoid possible decline in the price of wheat, he sells ("shorts") ten contracts (50,000 bushels) of July wheat in the futures market. He has now locked in a price for future delivery. Should the price of wheat decline by July, he can buy back his futures, the profit offsetting the decline in the cash value of his wheat. Should the cash price have increased by that time, he will buy back his hedge at a loss but be compensated for that loss through the higher cash value of his crop. In a "perfect" hedge, the difference between the loss (or gain) in the cash market is exactly offset by the gain (or loss) in the futures market. Even when "perfect" hedges do not result, the risk to the producer or processor is usually reduced.

A long hedge might work in the following manner. An electrical supply manufacturer knows that he will need 50,000 pounds of copper for his product line. Since he must price the line in advance, he further knows that in order to protect his profit margin, the copper must be bought within a certain price range. In order to avoid the risk of increased copper prices, he can hedge by buying ("going long") two copper contracts in a month that coincides with his needs. Should the price of copper increase, he can terminate his long futures position at a profit which will offset his additional expense of purchasing copper at the increased market prices. Alternatively, he can actually take delivery on his two contracts. If cash copper prices decline, he can liquidate his futures position at a loss but satisfy his need with a cash purchase at the lower level.

As seen in these examples, the hedger does not seek to profit from his trading on the futures market; rather, he seeks to protect the profit he expects to earn in his commercial activities. The commodity futures markets enable the hedger to shift the risk of price fluctuation, which he seeks to avoid, to the speculator whose capital helps create the liquidity necessary for this to happen. The speculator assumes the risk of price fluctuation the hedger seeks to avoid.

The speculator, like the hedger, may take either a long or a short position on the futures market. Accordingly, he may profit or lose regardless of the direction of price trends. Though the futures markets exist primarily for commercial producers and users of commodities (including money), the speculators add liquidity, without which the markets would be unable to function effectively.

Options and straddles

Options represent the opposite end of the spectrum of activity in the commodities markets from taking delivery of physical commodities. There are three primary forms of options: calls, puts and doubles. In call options the "grantor" gives the buyer, or taker, the right to buy a specified quantity of a particular commodity, or to assume a long position in a futures contract on that commodity, at a striking price (the agreed upon price at which the option can be exercised), within a certain period of time running from the purchase date to the expiration date. A put option is the reverse, giving the taker the right to sell, or assume a short futures position, at the striking price, at any time between the purchase and expiration dates. A double option gives the buyer the right to either buy (that is, enter the long side) or sell (enter the short side), but only one, at the stipulated price. For the privilege conferred upon him, the taker of the option pays a premium to the grantor.

A call option is illustrated by this example. In January, September silver is trading at 420 (420 cents per ounce). A bullish investor could buy calls on 10,000 ounces at a striking price of 420 for a premium of $4,000. If the price goes up to 470 by September and the option is exercised, he has a profit of $1,000 before commissions. On the other hand, if September silver reached 470 within two months after purchase of the option, since it still has seven months to run, the option might have a value (sell for a premium) of approximately $7,400, for a $3,400 profit. Of course, if the price goes down or does not reach 460 after nine months, the taker stands to lose all or part of his premium.

A put works in precisely the opposite manner. In January, a bearish investor in gold, for example, would purchase, for a premium of $2,600, a put on 200 ounces of September gold at $240 per ounce. If gold drops to $210 by September, the investor has a 30 point profit, less the $2,600 premium per 200 ounces.

A "straddle" consists of simultaneously holding long and short positions. A straddle in commodity futures contracts could be comprised of a short position in March 1979 silver and a long position in May 1979 silver. The price difference between the two contracts is known as the "spread". The profit opportunity (and loss possibility) offered by a straddle results from changes in the amount of this "spread" between the straddled months.

Tax consequences

Generally, where a taxpayer purchases or sells a futures contract for his own account, it is a capital asset and gain or loss is capital in nature.[3] Moreover, a trader of commodity futures contracts will have capital gain or loss regardless of the frequency and number of trades he may make.[4]

However, a hedging transaction which is an integral part of a taxpayer's business and is not entered into with a substantial investment motive par ordinary gain or loss. The classic example is *Corn Products Refining Co.*[3] where the limited storage capacity of a manufacturer of corn products made it difficult for it to buy all the spot corn it needed for manufacture of its corn products when market prices were most favorable. Droughts might cause a sharp increase in the cost of its primary raw material. In order to guarantee its supply, taxpayer took a long position in corn futures as a method of acquiring raw corn at advantageous prices. It would take delivery on such contracts as it found necessary for its manufacturing operations and sell the remainder unless a shortage was imminent, in which event it would sell futures only as it bought spot corn for grinding. In this manner it secured a balanced position with regard to any increase in spot corn prices. The Supreme Court found the futures transactions to be an integral part of taxpayer's inventory management designed to protect the manufacturing operations against a price increase in the principal raw material. Accordingly, all gains were held to be ordinary in nature.

Because of changes made by the Revenue Act of 1978, the tax treatment of gain or loss on investments has become even more attractive to many investors. Under Section 1202, the deduction from an individual's gross income allowed in the case of net long-term capital gain has been increased from 50% to 60%. Effectively, only 40% of net long-term capital gain is therefore subject to tax, resulting in a maximum tax of 28% (70% of 40%). Nevertheless, net long-term capital losses can still be used to set-off ordinary income on a two for one basis (*i.e.*, $2 of net long-term capital loss can offset $1 of ordinary income), subject to the limitations of Section 1212. Moreover, the untaxed portion of net long-term capital gain is no longer an item of tax preference subject to the minimum tax for tax preferences or used as a reduction of personal service income subject to the 50% maximum tax. However, under Section 55, there is now an alternative minimum tax affecting net long-term capital gain when a taxpayer's effective tax rate falls below a range of 10% to 25%, depending on the amount of net long-term capital gain and itemized deductions he may have. The tax treatment of short-term capital gains and losses remains virtually unchanged as a result of the Revenue Act of 1978.

Although, under Sections 1222(3) and (4), a capital asset now must be held for more than one year in order for gain or loss from its sale or exchange to be long-term, the more-than-six-month holding period rules as they existed before enactment of the Tax Reform Act of 1976 apply to futures transactions in any commodity subject to the rules of a board of trade or commodity exchange. In this regard, the reports of the tax writing committees in Congress strongly suggest that they intended the exception from the one year holding period rules for futures contracts to apply only to *agricultural* commodity futures. Nevertheless, there is no ambiguity about the absence of any such limitation in the language of the statutory exception, and this has been confirmed by the IRS.[4] While not entirely clear, it would appear that the six-month holding period also applies to futures transactions on a foreign exchange or on a less organized exchange, such as the London Metal Exchange. Moreover, under Section 1223(8), in determining the holding period of a commodity received in satisfaction of a commodity futures contract, the holding period of the contract is "tacked on" to the holding period of the commodity.

In general, under Reg. 1.1233-1(a)(3), the holding period of the property delivered to meet a short sale determines whether a long or short-term gain or loss results from the sale. Moreover, the character of the gain or loss from a short sale depends upon the character of the asset used to close the sale. Nevertheless, the closing of a short sale will ordinarily result in short-term capital gain or loss where one invests in securities and commodity futures. This is because an investor usually goes short in anticipation of a decline in the market. His covering or delivery takes place only with property acquired specifically for the purpose of terminating his position. Section 1233 contains complex rules dealing with the delivery of property against the short sale where such property is acquired before the short position is entered into or during the period in which the short position is maintained. The purpose of these rules is to prevent the conversion of what would otherwise be short-term capital gain, if property held had been sold, into long-term capital gain, by the use of a short sale for delivery at some time in the future.

When a short sale is combined with a previously-held position, it is sometimes known as "selling short against the box." It is an investor's hedge. When an investor has realized a gain in a position, he may want to defer that gain into a subsequent taxing

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period. Rather than selling out completely, the investor can sell short, or go opposite to, the exact position he has. This locks in the gain, but the actual tax recognition does not take place until the short sale is closed at a later date. Again, though, Section 1233 will not allow the character of the gain to be changed, but a deferral is allowed.

The taxation of commodity options is governed by Section 1234. Under Section 1234(a), when one sells a previously purchased option or allows it to lapse, the character of the gain or loss is the same as would arise from the sale or exchange of the property to which the option relates had it been owned by the taxpayer. If the character of the gain or loss is capital in nature, then such gain is long-term or short-term depending upon the length of time the taxpayer held the option.

Section 1234(b)(1) provides that where a taxpayer is the grantor (or writer) of an option on securities or commodities, the gain on the lapse of the option and the gain or loss from any closing transaction with respect to the option is treated as short-term capital gain. The reader should be careful to distinguish this situation from the situation where the taxpayer is the seller of a previously purchased option as discussed above. Under Section 1234(b)(2)(A), "closing transaction" is any termination of the taxpayer's obligation under an option other than through the exercise or lapse of the option. A grantor usually effects a closing transaction by instructing his broker to purchase an option position identical to the one he has previously granted. These positions offset each other and the obligations of the taxpayer are terminated.

Both Sections 1234(a) and (b) contain an exception to their general rules. Section 1234(a)(3)(A) provides that Section 1234(a) does not apply to an option which is part of the taxpayer's stock in trade, *i.e.*, inventory. Section 1234(b)(3) provides an exception from Section 1234(b) for those who grant options in the ordinary course of their trade or business of granting options. Gains or losses of a taxpayer who fits under either applicable exception would be ordinary in nature. However, notwithstanding that a taxpayer is a dealer in options or writes options in the ordinary course of his business, if an option is bought and sold, or written, as part of a separate investment activity, the general rules apply.

It is not entirely clear how one establishes that he is buying, selling or writing options in the ordinary course of a business. The House Report states that principles used in determining whether a person is a dealer in securities should be used to determine whether someone writes options in the ordinary course of his business.[5] It also states that people who "make a market" with respect to options will be treated as writers of options in the ordinary course of their business. There are, though, numerous cases dealing with the issue of whether one is a dealer in securities and whether one writes options in the ordinary course of business.

Some of the factors considered in determining whether a person writes options in the ordinary course of his business include: (1) having a regular place of business; (2) being licensed as a dealer; (3) advertising as a dealer; (4) transacting a large volume of business; (5) subscribing to services commonly used by brokers and dealers; (6) profiting from the merchandising of the options granted rather than from a rise in the market value of the options; and (7) solicitation of business.

The IRS issued *Rev. Rul.* 78-182,[6] setting forth and amplifying many of the statutory rules discussed above, particularly as they relate to transactions on the Chicago Board Options Exchange (CBOE). While the Ruling specifically applies to stock options, its principles should be equally applicable to options on commodities and commodity futures.

The Ruling states that the cost of a call to the holder is a nondeductible capital expenditure. As to the grantor of a call, the premium received for writing the call is not included in income at the time of receipt, but is carried in a deferred account until the writer's obligation expires through passage of time, the writer sells the underlying stock pursuant to exercise of the call, or the writer engages in a closing transaction.

The Ruling goes on to state that if a taxpayer writes a call at a time when he has held the underlying stock for one year or less, or if the underlying stock is acquired after a call is written and before exercise or expiration, the writing of the call does not affect the holding period of the underlying stock. The effect of this is to treat the writing of a call differently from when stock is sold short or a put is purchased, in which cases the holding period of the stock is deemed to begin on the date of the closing of the short sale pursuant to the "short sale" rule of Section 1233(b).

Revenue Ruling 78-182 holds that the cost of acquiring a put is also a nondeductible capital expenditure. The premium received by the writer of the put is not included in income at the time of receipt, but is carried in a deferred account until the writer's

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[1] *[illegible]*, 120 F 2d 768, 41-2 USTC ¶9512, 27 AFTR 583 (CA-5, 1941), *cert. den.*
[2] *Ferrell*, 231 F.2d 281, 56-1 USTC ¶9307, 48 AFTR [illegible] (CA-5, 1956).
[3] 350 U.S. 46, 55-2 USTC ¶9746, 47 AFTR 1789 (S. Ct., 1955).
[4] IR-1787, 3/30/77.
[5] H. Rep't No. 94-1192, 94th Cong., 2d Sess., (1976).
[6] 1978-1 CB 265. See [illegible] current tax effects of puts, calls and straddles, 21 TA 8 (July, 1978).
[7] 1977-1 CB 68.
[8] See, e.g., *Rev. Rul.* [illegible], [illegible] CB [illegible], and *Ltr. Rul.* [illegible].
[9] IRB 1978-48, 6.

obligation expires through the passage of time, until the put is exercised, or until the writer engages in a closing transaction.

The Ruling states that, for purposes of Section 1233(b), the acquisition of a put is a short sale and the exercise, sale or expiration of the put is a closing of the short sale. If the put is acquired at a time when the underlying stock was held for one year or less, or if the stock is acquired after acquisition of the put and before its exercise, sale or expiration, any gain resulting from the exercise, sale or expiration of the put must be short-term capital gain. Additionally the holding period of the stock begins to run on the earliest of (1) the date the stock is disposed of, (2) the date the put is exercised, (3) the date the put is sold, or (4) the date the put expires.

Tax strategies

The tax structure for futures and options transactions has generated a myriad of strategies for deferring income or converting the character of gains or losses.

Recognition of short-term capital loss and long-term capital gain. Assume that taxpayer, on June 1, 1979, enters into a contract to sell ("goes short") 5,000 ounces of March 1980 silver and, at the same time, enters into a contract to buy ("goes long") 5,000 ounces of May 1980 silver. On December 10, 1979 (more than six months later), assume that the silver which is the subject of both contracts has risen in price by 40 cents an ounce. If taxpayer were to close out each contract, he would have a long-term capital gain of $2,000 on his long position of May 1980 silver and a $2,000 short-term capital loss on his short position of March 1980 silver.

If the price of silver had declined, the taxpayer's strategy would be to close out the long position before his holding period exceeded six months, in order to recognize a short-term capital loss. The closing of each contract before the end of the six month holding period will usually result in a wash of gain and loss, since both positions are short-term.

Deferral of a capital gain. If a taxpayer has large short-term capital gains in the current taxable year, commodity futures frequently have been used to recognize loss in one year (against which he can offset short-term capital gains), delay recognition of gain until the next year and possibly convert such gain into long-term capital gain.

In November of 1979, taxpayer goes short 5,000 ounces of March 1980 silver and goes long 5,000 ounces of May 1980 silver. If the market price of silver rises 40 cents an ounce, taxpayer could close out his short position in March 1980 silver and recognize a $2,000 short-term capital loss. Taxpayer would then go short July 1980 silver in order to be somewhat protected against a decline in silver prices. In 1980, the long position in May 1980 silver and the short position in July 1980 silver could be sold with a resulting net short-term gain approximately equal to the $2,000 short-term loss recognized in 1979.

In *Rev. Rul.* 77-185,[7] the IRS held that the short-term loss generated in a "silver straddle" such as that described above is not deductible. The basis for the IRS position is that under Reg. 1.165-1(b), there was no real economic loss in the first year because the taxpayer always maintained a balanced position and, therefore, the "loss was not evidenced by a closed and completed transaction" fixed by identifiable events and "actually sustained" during the taxable year. The IRS also stated, as fact, that the taxpayer had no reasonable expectation of deriving a profit from the transaction.

Substantial criticism of the IRS position in *Rev. Rul.* 77-185 has been asserted on a number of grounds. First, the position of the IRS is contrary to and inconsistent with judicial authority and the prior positions taken by the IRS itself.[8] Second, the IRS, in taking the position that the taxpayer involved in *Rev. Rul.* 77-185 was always in a balanced position, ignores the fact that commodity futures contracts calling for sale or delivery in different months are not substantially identical under Section 1233(e)(2)(B). Moreover, the reliance of the IRS on Section 165 and Reg. 1.165-1(b) for the proposition that an overall economic loss must be sustained is unfounded. Rather, the language indicates that the requirement that a loss be "sustained" before becoming deductible is only a timing requirement. To what extent a loss is sustained for measurement or quantitative purposes is to be determined by specific sections of the Code, *e.g.* Sections 1001, 1211 and 1212, and not by Section 165.

Conversion of ordinary income into capital gain. It has been maintained that certain commodity transactions can have the effect of converting what would otherwise be ordinary income in one year into capital gain in a later year. Such potential exists when investing in what is known as a "cash-and-carry." Assume that on March 1, 1979, an investor purchased 5,000 ounces of silver ("spot") for $5.62 per ounce (a total sales price of $28,100). Most of this purchase is ordinarily financed. Simultaneously, the investor sells short 5,000 ounces of July 1980 silver for $6.00 per ounce (a total sales price of $30,000). The investor now has an initial profit of $1,900 on the spot silver which he could deliver against his futures obligation. The increased price for silver in the future is based upon expectations of the cost of money (interest rates), and storage and insurance costs required through the delivery date. This is the normal state of the market known as "contango." The investor hopes to make money in a cash-and-carry transaction due to expectations he may have of serious distortions in the markets which could force the spot price to increase more than the futures price (sometimes known as a "backwardation"). In the meantime, the investor should be able to deduct against ordinary income the expenses for storage and insurance for the silver plus the interest paid on the financing of the silver (subject to the limitations on the deductibility of investment interest under Section 163(d)). Since the opening spread is usually based on these carrying costs at the time the transaction is entered into, the initially anticipated gain on the spread will be an amount which is very close to the carrying costs.

The sale of the spot silver or use of it to close the short position is not covered by the short sale rules which, under Section 1233(e)(2)(A), only affect securities and commodity futures which are capital assets in the hands of the taxpayer. Therefore, long-term capital gain results if the silver is sold or used to close the short sale any time after March 1, 1980. The reason the investor must have held the spot silver for more than one year in order to recognize long-term capital gain is that the allowable six-month holding period applies only to commodity futures, not to the actual commodity itself.

Many of the techniques discussed above, contemplating the use of commodity futures contracts, can similarly be applied to stock options or, where permitted, commodity options. Further, while transactions entered into by an individual investor in options will be taxed as capital gains or losses, it is possible that such an individual could invest (as a partner) in a business which acts as a dealer or market-maker in options and, accordingly, receive the benefits or suffer the detriments of the gains and losses being taxed as ordinary in nature to the extent they occur in the ordinary course of the partnership's business.

Treasury bills

With the effect that interest rate and currency fluctuations have assumed in our economy, substantial need and great interest has been generated in hedging these fluctuations. One of the most successful market innovations in history was introduced in October of 1975, when the Chicago Board of Trade began trading futures contracts on "Ginnie Maes" in a manner similar to commodity futures. This was followed shortly thereafter by the beginning of trading in futures contracts for United States Treasury Bills on the International Monetary Market.

A Treasury Bill future is a contract to purchase or sell a fixed amount of Treasury Bills at a future date at a fixed amount. The basic trading unit is one million dollars of face value Treasury Bills for delivery in from three to 12 months. A futures position in Treasury Bills can serve as a hedge against interest rate fluctuations because as interest rates rise the Treasury Bill and the corresponding futures contract will decline in value. Therefore, for example, a short position in a rising interest rate market can produce profits to offset increasing finance costs. The great fluctuations in the market and the resulting active interest of hedgers have been followed by a substantial speculator interest in these markets.

Prior to November 1978, there was doubt as to the proper tax treatment of transactions involving Treasury Bill futures. A number of writers suggested that since a Treasury Bill itself is not a capital asset under Section 1221(5), a futures contract on a Treasury Bill should not be treated as giving rise to capital gain or loss. Therefore, as with a Treasury Bill, any gain or loss would be an ordinary gain or loss.

In November of 1978, the IRS, in *Rev. Rul.* 78-414,[9] ruled that Treasury Bill futures are capital assets (unless used in a hedging transaction). The rationale is that transactions in commodity futures contracts are transactions in rights to the commodity rather than in the commodity itself. Accordingly, the Ruling states that even though a Treasury Bill is not a capital asset, the purchase or sale of a commodity futures contract for future delivery of a Treasury Bill is the acquisition of rights to Treasury Bills and therefore gives rise to capital gain or loss.

With this Ruling that a futures contract covering a non-capital asset is treated as a capital asset, an interesting question presents itself: Why would anyone invest (as opposed to hedge) in the asset itself (Treasury Bills) rather than in the futures contract? This question seems to have been addressed by the Supreme Court in *Corn Products:*

"To hold otherwise [*i.e.*, to allow a hedger to recognize capital gains on futures transactions] would permit those involved in hedging transactions to transmute ordinary income into capital gain at will. The hedger may either sell the future and purchase in the spot market or take delivery under the future contract itself. But if a sale of the futures created a capital transaction while delivery of the commodity under the same future did not, a loophole in the statute would be created and the purpose of the Congress frustrated."

While the IRS position in *Rev. Rul.* 78-414 may have taken some people by surprise, it would appear that the sale of a previously purchased option on a Treasury Bill still would result in ordinary income or loss to the purchaser, because, under Section 1234(a) the taxation of an option is specifically said to depend on the character of the underlying asset. On the other hand, any gain or loss to a grantor of an option on Treasury Bills or Treasury Bill futures would always result in short-term capital gain or loss to the writer under Section 1234(b), assuming a Treasury Bill is a "security" or "commodity."

By ruling that a commodity futures contract on a Treasury Bill is a capital asset, an investor might be presented with an election to treat gains as capital gains while treating losses as ordinary in nature. This could be done while investing in Treasury Bill futures through recognizing any gain by simply selling out one's position. However, if a loss has been sustained, say in a short position, the taxpayer might realize an ordinary loss by delivering the actual Treasury Bill to close the contract. An investor who has taken a long position and would otherwise have to recognize a capital loss on the sale of the futures contract, might obtain an ordinary loss by taking delivery of the Treasury Bills in satisfaction of his futures contract and recognizing an ordinary loss on the subsequent sale of the Treasury Bills.

It could be anticipated that the IRS would challenge such strategies, possibly on the basis that any loss accrued while the futures position was being held must be taxed as a loss realized from a futures position. However, this is inconsistent with all general concepts of reporting on a cash basis (the method used by nearly all investors) and is particularly inconsistent with the carryover and tacking theories prevalent in dealing with the conversion of a contract or right to acquire property to the actual property. (See, *e.g.*, the tacking of the holding period required under Section 1223(8) when a taxpayer acquires a commodity pursuant to a futures contract.)

Conclusion

Trading in the various futures markets has expanded so rapidly that such transactions are no longer considered "offbeat" or "exotic." The practitioner who has an understanding of these markets and the tax effects of the various types of transactions offers his clients a broader scope of counseling. ◆

F. "INSIDE THE LONDON SILVER TAX LOOPHOLE," ANDREW TOBIAS, NEW YORK, MARCH 8, 1976, PP. 33-38

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New York
MAGIC LOOPHOLE COMIX
LITTLE SCHEME
OH! I'M VERY WORRIED! MUST CONCOCT A SCHEME TO AVOID PAYING ALL THAT INCOME TAX! OH!
COME WITH ME, LITTLE SCHEME!

CRS MASTER FILE

Inside the London Silver Tax Loophole

By Andrew Tobias

"...It is either one of the larger illegitimate tax schemes on record, or else a perfectly legal way for anyone to cut his taxes in half. The Internal Revenue expert couldn't quite figure out which..."

Philip Stoller, who once described Wall Street as "the only place where they give you a desk and a phone and say, in effect, 'Here, go steal'" . . . and who for years kept a bronze caveat emptor plaque on his desk (but did most of his business by phone) . . . was released from federal prison in December, after serving eleven months of a 21-month sentence for securities fraud. He is not what you would be inclined to call an unimpeachable source. On the other hand, he knows a lot about fraud. On a recent Sunday, against the advice of his wife, his lawyer, his accountant, and various unnamed government officials, he says, he was driving in from his Woodmere, Long Island, home to tell me about what he calls "the London silver fraud."

I have since learned, with the help of a technical expert from the Internal Revenue Service, that this so-called fraud, known to sophisticates as "London silver cash-and-carry," is most likely one of two things. It is (a) one of the larger illegitimate tax-avoidance schemes on record (although not necessarily an out-and-out fraud), or it is (b) a perfectly legal transaction by which any one of us—me, you, or the postman—could cut his tax bill roughly in half (up to certain limits). Unfortunately, the IRS expert couldn't quite figure out which.

I was particularly interested in what Stoller might have to say inasmuch as one of the thousand or more high-income taxpayers in on the deal—in all innocence, believe me—is my father.

(The government, too, appears interested. Both the IRS and the United States attorney's office have investigations under way.)

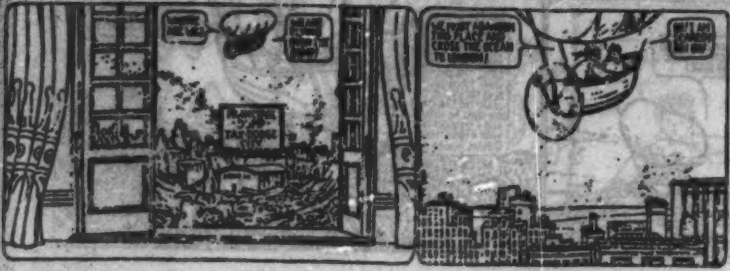
Stoller, a likable, nicely dressed, quick-witted, chipmunk-cheeked, loose-tongued white-collar ex-criminal of 45, average in height and leaner now than when they packed him off to prison, showed up at my apartment promptly at 10:30 Sunday morning. He had been out until two the previous night, he said, eating and drinking at Sammy's on Chrystie Street. But even after driving all the way back out to the island, and then back in again, he seemed fit and ebullient. And a couple of double Scotches the other side of noon didn't dampen his enthusiasm.

He has a special interest in this case. Having tipped the government off to it in the first place, in an effort to get out of jail early and have other pending prosecution dropped, he subsequently applied to the IRS for a reward. The IRS customarily pays informants from 1 to 10 percent of the taxes that are recovered as a result of their help, and Stoller figures there may be a billion dollars involved in the London silver fraud. One percent of $1 billion is—$10 million. And while it seems most unlikely that the government will ever pay Philip Stoller $10 million—or that anywhere near a billion dollars is involved—the prospect has evidently provided him with some direction at this juncture in his life. (He is also planning to open a bookstore.)

Stoller claims that thousands of wealthy individuals throughout the country have cheated on their income taxes (many of them unwittingly, on the advice of their tax consultants)

[illegible]

V.9


TAX DODGE CITY
WE MUST ABANDON THIS PLACE AND CROSS THE OCEAN TO LONDON!

". . . Stoller claims that, unbeknownst to most participants in the silver cash and carry scheme, there isn't even any silver . . ."

with a simple transaction involving the purchase and sale of silver in London. Not only does he maintain that the transaction creates a tax benefit that should not be allowed under the existing tax code; he claims too that, unbeknownst to most of the participants, *there isn't even any silver*. "The only silver is in the typewriter that's used to type up the phony confirmation slips," he says. Like all that salad oil that wasn't in Anthony De Angelis's tanks, or all those oil wells Home-Stake Production Company never drilled.

Even if the silver *is* there to back up the transactions, as I am naive enough to believe it mostly is, there is still no question that London silver cash-and-carry violates the spirit, and very possibly the letter, of the tax code. Here is how it works.

The idea is to convert ordinary income (like your salary) into a long-term capital gain. The reason, simply, is that long-term capital gains are taxed only about half as heavily as ordinary income.

First you buy, say, 100,000 ounces of silver for $400,000. To do this, you borrow $400,000 from your commodities broker. (Don't worry; for this deal even the postman could probably get the money.) The interest on $400,000 for seven months costs you about $25,000, *and it is fully deductible*, just like the interest on a house, or any other interest.

In the meantime, the last thing you are prepared to do is sit around owning 100,000 ounces of silver, which could decline in value while you are holding it . . . so at the same time as you buy the 100,000 ounces, you *sell* 100,000 ounces* in what's called the "futures market." This means you agree to deliver 100,000 ounces of silver at a specified time (say, seven months hence) for a specified price (say, $425,000). It also means that you have eliminated any real risk.

Comes seven months later, and no matter what has happened to the price of silver in the meantime, you deliver your 100,000 ounces as agreed for $425,000—and lo and behold, after paying back your $400,000 loan you are left with a $25,000 long-term capital gain, only *half* of which is taxable.

Of course, absent tax considerations, you haven't made any gain at all. You merely paid out $25,000 in cash at the start (or in installments) and got it back again seven months later. And the gain was "long term" in name only, as it was locked in, wrapped up, signed, sealed, and all but delivered within minutes. But the inventors of this transaction thought—correctly, as it turns out—that they could sneak it by the watchful and conscientious Internal Revenue Service.

For one thing, the transaction is generally arranged so that the interest deduction is taken in one taxable year, while the "long-term gain" is realized and declared in the next. That way, particularly if the IRS is auditing only one of the two years' returns, the nature of the transaction is much harder to spot.

For another, lots of commodity straddles and assorted other financial games, while they may strike some philosophers as providing unfair tax advantages, are entirely legal. What would seem to disqualify this one, if anything does, is this Catch-22 principle of the tax code: namely, that any transaction which has no substantive object other than to reduce one's taxes—does not qualify to reduce one's taxes. There must be a reasonable expectation that some profit could be realized other than the profit in reduced taxes. With the London silver straddle, the chance of realizing a *true* profit (explained below) is highly remote, and most of the taxpayers in on the deal probably don't even know it exists.

Yet, who's to say? When exposed to the full light of day, and to full IRS scrutiny, London silver cash-and-carry could conceivably be ruled to be within the letter (if not the spirit) of the tax code. If so, the line to get in on the deal might as well form behind me. Who wouldn't want to convert—risklessly, effortlessly—his ordinary income into a long-term capital gain? Why don't we all do it? Of course, as soon as the masses got wind of it, it would be outlawed, and the six-figure-a-year tax specialists would move on to uncover some new loophole for their clients.

(In fact, they already have. London silver cash-and-carry is "last year's" tax dodge, several accountants told me. "It's come to have a bad smell." *This* year's favorite is "the closing transaction" [see box on page 38]. Also, it should be noted, there is already a $25,000 limit on the amount of investment interest that may be fully deducted from one's salary-type

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**For appearances' sake, maybe you wait a few minutes. Or else you buy it at the close of trading one day and sell it at the opening of trading the next day.*

[illegible] income in a given year. In his position, earning well in excess of $50,000, [illegible] to Stoller. Furthermore, there is a bill now in Congress that would bring the limit down even further—and go a long way toward spelling more very [illegible] tax (dollars.)

The beauty of silver for the purposes of this scheme, as opposed to, say, wheat, is that the "capital gain" you lock in by selling silver in the futures market is almost always roughly equivalent to the interest cost on the silver you buy. And you don't have to worry about rats eating it between the time you buy it and the time you've agreed to deliver it.*

Throughout all this, let me hasten to make clear, you need never actually see any silver. You just assume that your broker in New York, and his broker in London, do whatever brokers do with silver. On the other hand, since you are buying and selling identical amounts of the stuff, and have no intention of closing out one side of the transaction without the other, from the broker's point of view—if he were that kind of broker—there really wouldn't have to be any silver at all. It would be the financial equivalent of "let's not and say we did." Who's to know?

Which brings Stoller's other contention bubbling to the surface:

If there are 2,000 participants in this tax transaction, an estimate none of the people I spoke with would consider unreasonable, and if the average participant buys 75,000 ounces of silver (which would serve to convert about $30,000 from ordinary income to capital gains), then one might expect to find 150 million ounces of silver (2,000 times 75,000) sitting around somewhere in London for the purposes of this transaction alone. Even in the vaults of London's five major bullion dealers (who may have, among them, over 100 million ounces in inventory), that's a lot of silver. And the London Metal Exchange, which has less than 20 million ounces in its vaults, is the more likely depository for this kind of silver. Makes you wonder.

Stoller claims that the London silver scheme was invented in 1970 by a respected commodities broker named Stanley Kroll, of Kroll Dalon & Company, out of whose office he had previously been allowed to operate. One day Kroll explained the hoped-for tax consequences of the deal to Stoller, Stoller says, and suggested that he offer it to his clients. Stoller declined, he says, on the ground that "it was so transparent it would be uncovered in six months." Now, however, he thinks that but for him the scheme might have gone on forever. "The most obvious fraud in the world is usually the one that's not uncovered," he muses. "How did it go in *The Emperor Jones*? 'For de little stealin' dey gets you in jail; for de big stealin' dey makes you emperor!'"

According to Stoller, after Kroll pioneered the idea "it began proliferating like gerbils." Other commodities brokers began peddling it. High-tax-bracket lawyers used it to shelter their own income, then decided to let their clients in on it, too (for which, Stoller claims, some got kickbacks). And so it grew. He names two of the Big Eight accounting firms he believes have put clients into the deal (including the firm that always seems to get messed up in these things), and he suggests that, in all, there may be 10,000 or 15,000 taxpayers involved—or more. (One of the principal New York commodities dealers doing the transaction estimates that 1,000 to 2,000 is probably more like it.)

Kroll, 41, author of *The Professional Commodity Trader* (Harper & Row, 1974) and owner of a boat called the *Quicksilver*, could not be reached for comment. He has retired and liquidated his firm. His lawyer advises that he is sailing in the Caribbean, taking a break from research he is doing on a book about Europe's inland waterways. Kroll did lots of cash-and-carry transactions for his clients, his lawyer says, all strictly legal. He and most of the other commodities brokers doing London silver cash-and-carry have been called down to the U.S. attorney's office, his lawyer says: and in Kroll's case, at least, the government was given full access to all their files.

Stoller claims that the government is readying a massive indictment, picking and choosing among these 10,000 or 15,000 taxpayers to find the ones it has always wanted to get on other charges, but never could—like certain questionably connected Wall Street lawyers. He even claims to have gotten an anonymous, but highly unlikely, phone call recently that went something like this: "Mr. Stoller, we would appreciate it if you would not press the hold button, and if you would not record this conversation, although there is nothing we can do about it if you do. We know your wife is out and your children are at school. You have

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**The reason the premium is roughly equal to the interest is simply that you are, in effect, financing some company's stock of silver until it's ready to use it. If Eastman Kodak knows it will need silver seven months hence and wants to be sure of the price, it can either buy and stash some and carry the silver in its inventory—but lose the use of all that cash—or else it can, in effect, pay you to carry the silver for it. You become the banker for Kodak, and your so-called long-term capital gain is really just an interest payment from Kodak. Need I mention that interest is taxable as ordinary income?*

"...Now my father, like Richard Nixon, is not a crook. But unlike Richard Nixon, he really isn't. He pays a lot of taxes..."

caused a great deal of difficulty for a number of our people. We realize it was not intentional, but in addition to costing them a lot of money, you may be giving the government the one shot at them they could never get before. We think it would be in everyone's best interests if you would not pursue this matter any further." There is no way of verifying that Stoller got such a phone call. He does ask that it be made clear that he is interested only in the record, and that he is not out to make trouble for anyone.

The IRS confirms that an investigation is under way—but will not discuss its progress and cannot say whether any of Stoller's claims have been substantiated. In any investigation, a spokesman explained, the element of surprise is important. He does say, however, that where foreign governments are involved, things take time . . . certain channels must be gone through, certain quid pro quos arranged . . . and that in the past the IRS has had a good relationship with the people on the other side of the Atlantic.

The United States attorney's office is even more closemouthed. Its policy is never to confirm or deny the existence of an investigation. However, in responding to Stoller's motion for a reduced sentence, Assistant U.S. Attorney Ira Lee Sorkin noted in July, 1975, that "as a result of the information provided by Stoller, the United States attorney has commenced an investigation into transactions in spot silver and silver futures on the London Metals Exchange." Sorkin won't comment on the progress that may have been made, or on whether the investigation is even still active.

Now my father, like Richard Nixon, is not a crook. But unlike Richard Nixon, he really isn't. He pays lots of taxes, this London silver thing notwithstanding, and he is exceedingly charitable, to boot. For 25 years he has been paying thousands of dollars in Westchester school taxes alone (not to mention property taxes, three income taxes, unincorporated business taxes, sales taxes, and Social Security taxes)—and neither of his children ever spent a day in a Westchester public school. (This year's school tax cost him $3,218.) Every year he is audited, and every year he passes with flying colors, simply because he files an honest return. He is not crazy about paying all these taxes, however, so, like anyone, he looks for ways to reduce the burden. Last fall, his accountants suggested London silver cash-and-carry. No risk, they said; a way to convert ordinary income into a long-term capital gain. Lots of their other clients had been using it, they said, and it had even stood up to IRS audits.

He asked the advice of his-son-the-supposed-financial-expert, and I told him, "What do I know about silver straddles? It sounds a little outrageous, but we all know there are outrageous loopholes—don't ask me, ask your tax specialist."

His tax specialist, which is to say his accountants, assured him it was okay, and arranged the transaction through a local commodities broker.

My father's accountants, Goldstein, Golub, Kessler & Company, would not speak to me about London silver cash-and-carry, even on the assurance that if someone did, I would agree to keep the firm name out of the article. (On the theory that what they could tell me about the legality of the loophole and the existence of the silver would be more interesting than the name of their firm.) They declined, on the ground that it would be violating the confidential relationship they had with other clients. My father pointed out that he was one of their clients, and that it could hardly be in the interest of their other clients to focus IRS attention on their firm. But they held their ground. They did advise him that it was still their opinion that the interest deduction was valid for 1975, and that the gain he would realize in April, 1976, would be a long-term capital gain. As for the silver itself, they explained that they were accountants, not commodity brokers, and had no reason to think the broker who handled the transaction had done anything amiss.

The broker through which Goldstein, Golub arranged my father's cash-and-carry struck me as forthright and sincere. He said that over the last year he had been swamped with accountants and others exploring the possibilities of London silver cash-and-carry—and that it was astounding to him how little most of them understood about the commodities business—but that in the final analysis, the only firm that wound up doing business with him was Goldstein, Golub & Kessler. He didn't know offhand exactly how many clients the firm had referred to him, but said the number was under 100. Unlike many of the other accountants who had come to him, he said, Gold-

WHO WAS THAT MASKED MAN?
WHY, THAT WAS THE LOAN ARRANGER!

sale, Golub seemed to have a reasonably good grasp of how the transaction worked. (The firm, its reticence notwithstanding, has a good reputation for honesty and competence, from what I can gather.) No, he said, he did not pay Goldstein, Golub any sort of commission or kickback for its business.

He made it clear to me, and says he has made it clear to all the people who have sought his advice on London silver cash-and-carry, that he is not a tax specialist, but simply a commodities broker, in business to make the trades his customers request. But it was his understanding, he told me, that the clients of Goldstein, Golub went into the transaction purely for tax purposes, and not with any thought of realizing the profit that could conceivably result through a rapid and dramatic narrowing in the "spread" between spot silver and future silver. (Goldstein, Golub never mentioned anything about spreads to my father.)

When I asked why my father's confirmation slips showed that the purchase had been made on October 1, and the sale on October 2—why not all at once?—he allowed as how he thought this had been done to introduce the appearance of risk into the transaction (the risk that silver could plummet in between the time of purchase and sale). But he said that the risk was negligible, particularly as it was his understanding that the purchase would be made at the close of trading one day, and the sale made at the opening the next.

And where, exactly, was the silver? In London, someplace, he told me candidly—he did not know exactly where. His firm merely transmits these orders through the British firm of Kreglinger & Manuel (Futures) Ltd., which arranges for the financing, insurance, and storage of the silver. He wasn't sure where they stored it or who insured it; he merely passed these charges on as billed to him by Kreglinger, on to his customers. ("Storage!" snorted Stoller, who is convinced there is no silver. "That's a laugh.") All my father's broker got out of the entire transaction, he said, was about a third of the $1,244.67 brokerage commission.

The second broker I talked to, who has nothing to do with my father's account (and who Stoller said would hang up on me immediately if I called him for an interview), seemed equally forthright, and more knowledgeable, but he told a slightly different story.

According to this man, London silver cash-and-carry is primarily a hedge against world financial panic—like an insurance policy—with tax benefits a mere by-product. His clients have gone into it, he says, with the idea that one of these days there will be a run on silver (precipitated, perhaps, by a failure of confidence in paper money), just as, in days gone by, there used to be runs on banks. He points out that the current world rate of silver consumption, in things like film and anti-pollution devices, has come to outpace the rate of silver production. And that if a panic ever started, with silver speculators running to cover their short positions, the price of spot silver—silver today—could zoom, while the price of future silver (which is of no use to the man desperate to cover his short position) might lag behind. In that case, the "spread" between the two prices might not only narrow—it might invert! Silver might go into what commodity traders call "backwardation," meaning that spot silver might become even dearer than silver for future delivery.

This sort of thing happens every so often in something like cocoa, because of bad weather, or copper wire (where a builder who is all set to finish his office building would pay just about anything to get in the wiring so the dozen tenants can move in—copper six months from now will do him precious little good). But it never seems to happen with silver. Well, once, to a tiny extent.

Nonetheless, that is what this broker says his clients are all waiting for, even if they don't mind the tax advantages that come along with the deal. Because if silver does go into backwardation, they will be able to sell their spot silver at crazy, wonderful prices, and for a relative song buy back their obligation to deliver it on the futures market.

Yet the one piece of literature I have seen from this firm includes a headline about "converting ordinary income to long-term capital gain"—but makes no mention of panic, profit, or backwardation.

As for why there seems to be relatively little silver sitting underneath the London Metal Exchange in relation to the amount American taxpayers may have bought, this broker (unlike the other, who assumes there is a warehouse receipt for each bar of bullion) compares the situation to a bank: If all the depositors came on the same day for their money, no bank in the world could survive. But that doesn't mean that they haven't got your money.

Somehow I'm not sure this is entirely analogous, but why quibble over 50 million or 100 million ounces of silver?

Frank Godfrey, head of the Kreglinger firm through which my father's broker works, was "on the Continent" and unreachable last week. His associate said that Godfrey was the only one knowledgeable in Kreglinger's silver business. Kreglinger, it turns out, is not a well-known firm and not even a member of the London Metal Exchange.

I had an interesting session with the

"...Didn't IRS have any sort of special 'loophole task force'? I wondered. No, I was told, we're not organized that way..."

IRS. Two spokesmen from the New York office stood ready to assist me—one a public-relations official, the other a technical expert. They had had advance notice of my visit, and a general list of the kind of technical questions I would be asking. They also were familiar with "the London silver fraud" as the result of a back-page *Wall Street Journal* article that had broken the story of Stoller's allegations three weeks before. (The writer, Stanley Penn, had been to see one of the same spokesmen I was seeing.) So this was no pop quiz, like the ones Mr. Alexander used to spring on us in the eighth grade.

What I wanted to know, simply—forgetting the possibility that there might actually be no silver, in which case it was most certainly a fraud—was whether or not London silver cash-and-carry created a legitimate long-term capital gain. The answer, after much technical puzzling—and subject to one more thing the expert wanted to check in the morning—was no.

How, then, could it have slipped by the IRS for five years? "We are only human."

But surprisingly, I got a call from the technical expert the following morning stating that, having checked further, he had discovered that the transaction wouldn't fall under "the short-sale rule," as he had previously thought, and that (for reasons only a person so involved in the research as me would find interesting) the transaction would indeed qualify for a long-term gain. "Aha," I said. "You are telling me, then, that any American taxpayer may convert his ordinary income into a long-term capital gain by means of this virtually risk-free transaction?" Well, apparently so.

He called back a little while later to reverse his position. Such a transaction probably would not qualify for long-term-gains treatment.

And then he called back a third time with the answer I had rather expected to hear the day before: If they recognized what the taxpayer had done, they would probably challenge it on the basis that there was no profit motive other than reduction of taxes. Then it would be up to the courts to decide, he said.

Well, hadn't any of these thousands of returns ever been challenged, and hadn't the court decided? Apparently not.

Now, however, IRS is likely to be more watchful. Now that the Wall Street lawyers have had their fling with it, the postman would not be likely to get far with London silver. What's more, the IRS indicates that it may go back to the taxpayers who used this device—even to those previously audited—to recover the taxes that may in fact be due.

I would never run through such an embarrassing chronicle of IRS reversals if the point I was trying to make were incompetence. That is not the point. There are two points.

First, how can we really expect $20,000-a-year public servants to battle effectively against $200,000-a-year lawyers and accountants out to outfox them? (Didn't IRS have any sort of special "loophole task force," I wondered, to try to deal with the opposition? Weren't there specialists in real-estate shelters, oil shelters, movie shelters, and, yes, London-silver shelters? No, I was told, we are not organized that way.)

Second, who the hell can be expected to understand the American tax code? Which leads us to "the ultimate loophole," as Citicorp chairman Walter Wriston calls it. Wriston, Treasury Secretary William Simon, and a growing list of congressmen are suggesting a drastic overhaul and simplification of the American tax system. One popularly quoted figure is that if everyone—individuals and corporations—paid a flat 16 percent federal income tax, without any deductions, the government would raise just as much tax revenue as it does now. ("But then the politicians would have nothing to give away to special interests" objects one cynical observer.) Wriston thinks such a proposal, perhaps graduated to a maximum 20 or 30 percent tax rate, could prove highly salable. Who but the special interests would oppose it? Who could come out against it, except, perhaps, on the ground of impracticality? (It would certainly cause quite a jolt in the economy before everything got realigned.) Wriston suggests that such a new system would free tremendous talent that now is wasted figuring out ways to beat taxes. But more than that, it would mean that business and investment decisions could be made not on the basis of their optimum tax consequences, but on the basis of optimum economic consequences. All too often these are not the same. All too often the creaky pile of incentives laid layer upon layer over the years, easily legislated and rarely revoked, distorts what would otherwise be sensible spending decisions.

When I first read Wriston's speech, "The Ultimate Loophole—Spend Your Own Money," I confess to having been overwhelmed by skepticism. A great concept, of course, but would it pass? And would it work? Who would pay more? Who would pay less? What would it do to charitable organizations that depend on tax-free contributions? Would I have to pay taxes on my agent's 10 percent fee—money that I never even see? Et cetera.

But having had a taste of London silver cash-and-carry, I am prompted to give Wriston's pamphlet a respectful second look. ■

This Year's Loophole

The latest star on the horizon of tax avoidance (which is legal, as contrasted with tax evasion, which is not) is "the closing transaction." This is a means of converting, among other things, a capital loss—only $1,000 of which is deductible in any given year—into an ordinary loss that is fully deductible. It is predicated on the fact that in the new options market, when you write (sell) an option and then cover it (buy it back) at a higher price, the loss you sustain is treated like a business expense and is fully deductible.

Let's say, for example, that you *buy* an option on IBM that matures in July, and at the same time *write* one that matures in April. If IBM goes up, you make a capital gain on the option you bought, which can be used to soak up capital losses from prior years; and you take an ordinary deduction for the loss you suffer covering the IBM option you sold. (If IBM goes *down*, you lose the premium on the option you bought, but keep the premium on the option you sold.) Unlike the silver transaction, this one—described here in only bare-bones form—has both real risks and lots of opportunities for real profit—and so, until they close the loophole, it is legitimate.

—A. T.

APPENDIX 6.—SELECTED ARTICLES

A. ARTICLES AND EDITORIALS ON THE SILVER AND RELATED FINANCIAL MARKETS

1. SILVER'S RISE AND FALL

Everything Has Silver Lining for N.B. Hunt

NELSON BUNKER HUNT
A lock on the market?

Quiet Texan 'Bullish' Over Soaring Price

By Jonathan Fuerbringer
Washington Star Staff Writer

He sat, waiting patiently.

In the eighth-floor reception area of the Commodity Futures Trading Commission, possibly the richest man in the Western world folded his hands in his lap and mused.

About silver, no doubt.

His lawyer chatted with him and disappeared.

Reporters drifted by and sat down to talk.

And Nelson Bunker Hunt rose each time from his chair to meet each new arrival.

Nelson Bunker Hunt, one of the heirs of Texas oil billionaire H.L. Hunt, *is* silver today. He has had the best ride in the last year on the back of a 300 percent price increase to more than $30 an ounce.

And now, he may have a lock on the market. At least, some traders are wondering if the adage that no man is bigger than the market is still true in silver.

His and his family's holdings in futures contracts for silver and ounces of silver are worth considerably more than $3 billion, by some industry estimates. Those holdings alone equal a third of the world's annual production of silver.

By his own reckoning, the world produces only 300 million ounces of silver a year, which would be worth about $9.6 billion at today's prices.

See HUNT, A-6

Continued From A-1

But the world also consumes 500 million ounces a year. This is the neat supply-and-demand balance that allows Nelson Bunker Hunt to say, "I'm bullish on silver."

But all his silver — and other wealth — doesn't show.

His suit is modest; ocean blue instead of the chocolate browns he is said to favor. His black shoes are not well polished.

His glasses rest midnose. He is quiet, not authoritative, even when talking about silver.

He is 53, stout and chatty.

He made general biblical references about the relationship between the value of gold and silver. And then apologized when he couldn't be specific.

He mentioned losing the silver dollar his wife recently gave him.

"After a couple of months, it was just gone," he said.

There is no hustle, frantic pace or sense of losing or making a bundle about him. Yet his silver fortunes ride in markets that move unpredictably from minute to minute.

He was reluctant to give advice about buying silver.

"I held a substantial position in silver for six years, and for five years the price went nowhere," he said.

"And now I am getting calls almost every hour asking me about silver."

Some of his friends followed his advice when silver was around $5 an ounce, Hunt said.

But they didn't take heed of the free hint to hang on.

"They told me," Hunt said, "they sold at $11."

But when Nelson Bunker Hunt says that the new sharp restrictions limiting ownership of silver futures contracts — which have been imposed by two major commodity exchanges — won't affect the market, it can't be chitchat.

This is the man the restrictions were aimed at, although neither the exchanges nor the Commodity Futures Trading Commission said so for the record. Even Hunt admited the restrictions will force him to reduce his holdings.

But the new limits didn't appear to worry him.

Nelson Bunker Hunt idled for an afternoon waiting for the opportunity to see a commissioner of the agency that is breathing down his neck on silver and took the Hunt family to court several years ago to break its hold on soybeans.

He even noted wryly that the limits on ownership of silver futures on the Chicago Board of Trade, which were announced last fall, may have helped push up the price of silver. The price had nearly doubled since then until it neared $40 an ounce last week.

"I came to see what was going on in silver," said Hunt, who came to the Commodity Futures Trading Commission Tuesday morning as the commission met on the problems in the silver market.

He returned again after lunch and after Commission Chairman James M. Stone had held a press conference announcing the restrictions on ownership. Stone repeated his concern about the concentration of thousands of silver contracts in the hands of one individual and the possibility this creates for price manipulation.

Hunt sat down and read a wire service account of Stone's press conference.

"I've never met Commissioner Stone," Hunt said.

Nelson Bunker Hunt would talk about silver but he didn't want to talk about money.

He demurred. "My position is sizable."

He was revealing only when asked if he is the largest commission-paying participant in the silver market today, which means he is doing a lot of business.

"I might have to plead guilty to that," he said.

Otherwise, Hunt said, "It's bad luck to talk about money or count your money."

WASHINGTON STAR JAN 10, '80

THE WALL STREET JOURNAL,
Monday, Feb. 4, 1980

Commodities

Curbs Due to Heavy U.S. Silver Trading Cause Concern Over the Markets' Future

By Robert Prinsky
Staff Reporter of The Wall Street Journal

Recent severe restrictions on U.S. silver trading—and the speculators whose big purchases forced the curbs—are raising basic questions about the future of the nation's booming futures industry.

Futures markets were developed for producers, users and brokers of commodities to protect themselves from losses due to changing prices. Lately, though, some large investors have turned to futures markets to obtain delivery of actual silver, much to the chagrin of long-time market users, who never expected to have to supply large quantities of metal against futures contracts.

Heavy buying has quintupled silver prices in the past year, forcing exchanges to limit the number of silver futures contracts individuals may own and the right of holders to obtain delivery of the metal. These actions bring into focus several issues that long have faced the futures industry:

—Should trading restrictions continue to be made by individuals with positions in the markets they supervise? A large foreign holder of silver futures has retained a Chicago lawyer to press the New York Commodity Exchange, or Comex, into reinstituting free trading in its market. The lawyer says the curbs may benefit some Comex board members who set them.

—Should futures markets remain places where delivery of goods generally isn't made? Fewer than 5% of contracts currently result in goods changing hands, and attempts to take larger deliveries triggered the curbs. James Stone, Chairman of the Commodity Futures Trading Commission, thinks exchanges should consider curtailing delivery rights.

—Should foreign participants in U.S. markets be able to escape regulation by hiding behind Swiss bank accounts and other forms of anonymity? Unidentified foreigners play a big role in the silver market. Rumor has it that some wealthy Saudi Arabians are pressing the State Department to use its influence to have free trading restored in the Comex silver market.

The rumor is denied by the State Department, the CFTC and the Comex, but at least two well-connected metal traders are convinced it is true. The stakes are high in this battle among silver traders, they say, and anything is possible.

On any day that silver's price rises $1, and there have been many of them recently, holders of short positions—or commitments to deliver silver—have to put up a total of $160 million or more in additional margin money. Holders of long positions, or commitments to receive silver, make that much in total on such days, because commodity-trading profits and losses are settled daily. These are huge sums to obtain from bankers in these days of tight and expensive credit.

The Comex board is composed mainly of dealers, brokers and traders of metals, in line with commodity market practice. "It's impossible to have a knowledgeable board without people who know about the market," and have positions in it, says one senior industry official.

"Shouldn't Be Decision Makers"

Yet, these people may make decisions on market rules that favor their positions, others say. "The law says that good faith is the fundamental principle" they should be acting on, says Thomas Russo, a partner in the law firm of Cadwalader, Wickersham & Taft. But a prominent metal trader declares flatly: "Position takers shouldn't be decision makers."

"If the people who made the decision may have stood to benefit the most, there is something wrong with the decision and the process from which it was made," says Philip M. Bloom, a Chicago lawyer. Mr. Bloom says he has been retained by a foreign holder of a long position on the Comex to press for a complete reopening of the exchange's silver market.

On Jan. 21, the Comex board ordered a ban on new positions in silver futures and limited trading to the unwinding of existing positions. Mr. Bloom says his client wants free trading resumed and is willing to institute legal action to obtain it. So far, though, Mr. Bloom says he has asked the Comex mainly for the minutes and voting record of the Jan. 21 meeting.

Lee Berendt, the Comex president, says the exchange is considering the request but doesn't generally distribute its minutes to outsiders. Board members "carried themselves respectfully" in making their decision and they "understand their obligations as members of the board," he says.

Talk of Moving to London

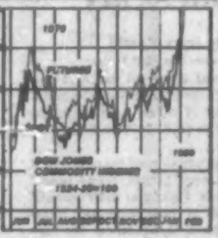
"These are trying times," Mr. Berendt adds. "We are a group of people trying to function in these times and hopefully to survive them." Some silver specialists wonder whether the trading curbs and some traders' irate reaction to them will spell the end of substantial silver futures trading in the U.S. Already there is much talk of activities moving to London, where regulation isn't as severe or as formal.

Many regulators are grappling with how to cope with the changed nature of the silver market. The Chicago Board of Trade, which also trades silver futures, has placed a more limited ban on new positions; it covers only February and March deliveries. There also is a 600-contract limit on individuals' holdings.

Some specialists suggest the Board of Trade's approach, which is aimed at limiting rights to obtain delivery, is a better approach than the all-embracing ban on new positions the Comex instituted. The Comex subsequently allowed new positions of as many as 50 contracts, starting today, but "I don't consider that amendment to be opening up the market," Mr. Bloom says.

Mr. Stone, the CFTC chairman, agrees recent silver trading "raises the question of whether position limits in delivery months might be useful. If there were such limits, the problem wouldn't have arisen as it did."

Commodity Indexes



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Futures Growth Too Rapid, Agencies Say

By Jerry Knight

Washington Post Staff Writer

Three federal agencies accused the Commodity Futures Trading Commission yesterday of allowing trading in "exotic" futures contracts to grow too fast.

The rapid expansion of futures trading in government bonds, home mortgages and other financial instruments was criticized at congressional hearing by high-level spokesmen for the Securities and Exchange Commission, the Federal Reserve Board and Treasury Department.

All three agencies have carried on a running fight with the CFTC over how and by whom financial futures markets are regulated, and yesterday they took their case to the house subcommittee that oversees commodity futures trading.

The CFTC is unable to adequately regulate the exploding financial business, the Treasury, Fed and SEC officials complained. Commodity regulators have not done enough to protect investors and to assure that financial futures markets are not manipulated by unscrupulous speculators, they charged.

CFTC officials had little opportunity to defend the agency because none of the complaints came up while CFTC Chairman James Stone was testifying before the subcommittee on conservation and credit.

Unlike most commodity futures, which allow investors to buy contracts for future delivery of corn, wheat or other farm products, financial futures are contracts for future delivery of financial instuments—Treasury bills, mortgages, etc.

Since the idea was first accepted by the CFTC a couple of years ago, 13 financial futures contracts have been created although several of them have failed to develop much interest among investors.

Stone assured the subcommittee that the CFTC is not rushing to approve the most controversial financial futures contract of them all—one based on a stock market index, such as the Dow Jones Industrial Average.

The Kansas City Board of Trade already has applied to start trading in futures based on the Value Line Stock Index. Other markets are preparing their own versions, based on other Wall Street fever thermometers.

The Federal Reserve requires investors to put up 50 percent of the price of stock in cash, but most commodity futures contracts require a down payment of only about 10 percent. Raising that to 50 percent would make stock index futures far less attractive to investors.

SEC General Counsel Ralph Ferrara says his agency believes the same regulations that apply to sale of any stock should apply to sales of stock index futures. The SEC's disclosure regulation and its rules to protect investors are tougher than those of the CFTC, he added.

Robert Carswell, deputy secretary of the Treasury, urged Congress to consider "whether the CFTC's resources are adequate" to regulate futures trading in Treasury bills and other government securities.

Peter Keir, assistant to the Federal Reserve Board, also urged curbs on financial futures markets. Much of the trading, he said, "appears to be designed largely to facilitate interest rate speculation, and a growing share of activity appears to reflect tax avoidance objectives."

The New York Times March 1, 1980

Crippled U.S. Silver Market

300 Million Ounces Owned By a Few

Nelson Bunker Hunt, who led the stampede into silver.

The New York Times / Mark Perlstein

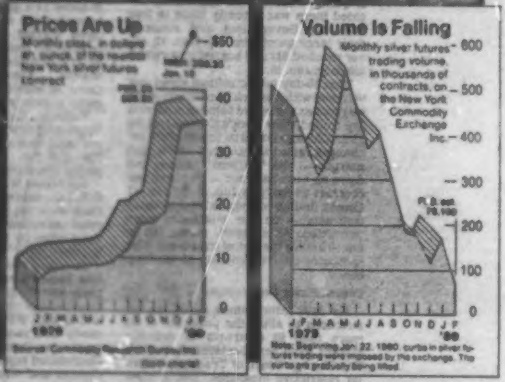
By H.J. MAIDENBERG

"For all intents and purposes, there isn't any silver market in the United States right now," said an official of the Commodity Futures Trading Commission, a Federal regulatory agency.

The seemingly unslakable thirst for silver that arose in the last six months has put nearly 300 million ounces of the metal into the hands of a few international financiers and companies. The peculiar twists and turns of the silver market have involved a relatively small cast of characters with two things in common: millions of dollars to invest and a keen interest in acquiring as much physical silver as possible.

The stampede they started in the marketplace, led by Nelson Bunker Hunt, the Texas oilman, sketched prices into a heady spin. Between January 1979 and Jan. 18, 1980, the price of silver spiraled from $6.30 an ounce to an unheard of $50.35.

How the Silver Market Has Changed



Source: Commodity Research Bureau Inc.

Note: Beginning Jan. 22, 1980, curbs in silver futures trading were imposed by the exchange. The curbs are gradually being lifted.

Erratic swings in price and a virtual panic among metals traders and users forced a temporary shutdown of the silver ring at New York's Commodity Exchange, or Comex, where contracts for future delivery of the metal are traded. The hurly-burly activity also piqued the interest — and concern — of the regulatory authorities in Washington.

The United States market has since settled down, but no one — including Federal authorities, exchange officials, traders, investors, industrial users and mining companies — is quite sure that it will ever be the same again.

As the C.F.T.C. official said, the question that remains is, "Will it ever be able to open up again?"

Companies whose operations require supplies of silver — photographic film and paper manufacturers, electronics, chemicals and jewelers, for instance — were especially hard pressed by the speculative fever. Some industrial suppliers like the Mocatta Metals Corporation and J. Aron & Company were also affected, but to a lesser extent because they are merchants who continuously trade the metal.

Holding 120 Million Ounces

When the dust settled early this month, Mr. Hunt reportedly owned or controlled through family interests between 120 million and 160 million ounces of silver, worth between $5 billion and $6 billion at current prices. These holdings virtually equal the amount of the metal used in the United States last year. No one, according to silver industry executives, has matched his appetite for the metal.

Mr. Hunt failed to return telephone calls to his office. Yet he has told reporters in recent weeks that he does not consider his role one of a market mover. "I am not a speculator," he said. "I am not a market squeezer. I am just an investor and holder in silver."

Other major participants in the play have been West German and Swiss banks, including the Soviet-owned Woschod Bank of Zurich, which act as bankers and brokers for large international investors.

Conticommodity Services Inc., the brokerage arm of the giant Continental Grain Company, reportedly owns between 50 and 60 million ounces. The mere appearance of Conti's chief metals trader, Norton Waltuch, on the floor of the Comex in recent months was enough to set off volatile rounds of buying.

The action began last summer. Prices had moved up slowly from $6.90 an ounce, on the January 1980 futures contract, on Jan. 1, 1979, to $9 on July 1. In late August, the big speculators who had been slowly acquiring more and more futures contracts abandoned any effort to mask their operations and prices began to explode. By Oct. 1, the price was $17.

The Federal Reserve Board action on Oct. 6, a move taken to strengthen the dollar, partly as a means of curbing

Continued on Page 30

Silver Market Crippled By a Few Rich Investors

Continued From Page 27

commodity speculators, contained prices to a range of $17 to $18 until Dec. 1. That's when buyers apparently decided there was actually little to fear from the Government and resumed their large purchases. By Dec. 31, silver reached $32 and soared to a record $50.35 on Jan. 18.

That 19-day hectic selling spree was watched with concern by officials of the two exchanges where futures contracts are traded, New York's Comex and the giant Chicago Board of Trade. Both exchanges raised the amount of the cash margin — the "earnest" money put down on each contract — required per contract as early as Jan. 8. On Jan. 21 Comex limited trading to liquidation of contracts — no new purchases were permitted. As a result, silver fell to $30.50 before the end of that week. The spot price closed yesterday at $26.30 an ounce.

Comex Eases Restrictions

Six days later Comex eased the restrictions to allow the purchase of no more than 50 contracts in delivery months from next September onward. The Chicago Board of Trade took similar restrictive measures. But to most people in the trade, the silver futures trade has been shattered.

Many of those trading were forced to liquidate some holdings to comply with the exchange restrictions; this caused silver prices to drop from a record high of $50 to about $35 an ounce — the level it has hovered about for the last five weeks.

The extraordinary volatility caused volume to fall dramatically. Comex's silver futures activity plunged from an average of 20,000 contracts a day last summer to roughly 4,000 in recent weeks, often falling to 2,000 lots at times. The Board of Trade's silver volume is half that of the Comex.

A major lure to speculators initially had been the low margin. Last summer, a 5,000-ounce contract could have been bought or sold for a mere $1,000. As a speculator's holdings increased in size and value, buyers used the higher value of the futures contracts as collateral for additional purchases. Buyers with Swiss credit facilities could borrow purchase funds at an interest of 4 or 5 percent in Swiss francs.

Many Pushed Out of Market

Last month, the exchanges required margins of as much as $75,000 a contract, a move taken to force undercapitalized buyers out of the market. Margins currently are $30,000 a contract.

The high margins and other restrictions pushed many out of the market, and since leverage is the most important advantage a commodity trader has, some silver investors fled to other markets.

Some of the stalwarts who remained — most notably Mr. Hunt — made it clear that they did not intend to close out their positions in a paper transaction. Their intent instead was to take delivery of the physical silver.

Normally, less than 5 percent of futures contracts involve the actual delivery of goods; the buyers and sellers having disposed of their positions long before maturity.

Lee H. Berendt, president of the Commodity Exchange, said recently that the unusual amount of silver that was delivered was the real problem.

Concentrated Holdings

"Not only was Comex not prepared to serve as a physical silver market," he said, "but neither is any other futures market. More important, we clearly saw that the big-buyer holdings were concentrated in a few delivery months . . . the shorts couldn't possibly come up with the amount of physical metal to satisfy the longs."

Publicly, Comex and the Board of Trade said that their actions in the silver incident were of their own volition. The C.F.T.C. has consistently supported this stance.

But James M. Stone, chairman of the C.F.T.C., said at the time the restrictions were imposed that "we have not ruled out action on our own if the initiatives taken by the exchanges prove to be inadequate."

To many precious-metals brokers like James Sinclair and others in the trade who are concerned about possible Government curbs on trading in gold and silver, Washington's power is already influencing these markets. In particular, the trade views with alarm the detailed reporting of the names, addresses and other data about traders that Comex and other exchanges have promised to provide the C.F.T.C.

Traumatized American Market

One C.F.T.C. commissioner, David Gartner, has sued his own agency to prevent it from forwarding such information to Congress or other Governmental entities.

The traumatized American market and threat of future disclosure of their trading operations have led many of the big speculators, including Mr. Hunt, to shift their operations to Europe where there are virtually no restrictions on trading. More important to the buyers, exchanges and brokers abroad need not disclose the names of traders and other details about their trading as they are required to in this country.

Mr. Hunt himself has said he doubts whether the American market will revive. "The market will move to Europe," he said. "The silver market in this country is a thing of the past." He said he had shifted his transactions to London and Zurich.

Mr. Hunt chafes at the strictures imposed by American officials. "I bought futures under the rules that existed," he was quoted as saying recently, "and suddenly the rules were changed. That doesn't seem fair."

THE WALL STREET JOURNAL,
Monday, March 3, 1980

Commodities

Fears of Silver Delivery Squeeze Abate, But Sag in Contracts Bothers Exchanges

By JULIE SALAMON
Staff Reporter of THE WALL STREET JOURNAL

First, silver watchers, the good news.

Fears that big speculators would cause a market squeeze in March by demanding delivery of more bullion than is available appear to be abating. Exchange restrictions on trading have sharply reduced the number of contracts outstanding for delivery in March and it appears the delivery situation "is going smoothly," says Lowell Mintz, chairman of the Commodity Exchange in New York, or Comex.

The remainder of the current silver story, however, is less cheery. The nation's futures exchanges are glum because the total number of silver contracts outstanding, a key measure of interest in their silver markets, has sagged by nearly 50% since January and by about 70% since a year earlier.

Industrial users of the metal are distraught because its price continues to hover at near-record levels and doesn't show signs of falling. On Friday, silver for March delivery settled at $35.30 an ounce, up 10 cents, on the Comex.

Fluctuations to Persist

Brokerage firms long for the good old days, as recent as three months ago, when brokers won nice commissions from the race to buy gold and silver. These days, "We discourage trading in precious metals," says John Hing, director of commodity research for Merrill Lynch, Pierce, Fenner & Smith Inc.

All that said, it isn't surprising the outlook for silver "holds little hope for stability" over the near term, says Handy & Harman, a leading silver refiner, in its latest annual review of the market. "It seems safe to conclude that frequent and even violent price fluctuations will continue to occur . . ."

Those fluctuations are likely to take place at higher levels, most analysts predict. Though few are willing to estimate how high, Charles Stahl, editor of Green's Commodity Comments and a noted silver enthusiast, forecasts a range of $45 to $60 an ounce "sometime this year."

Mr. Stahl observes that the big players, notably the billionaire Hunt family of Texas and wealthy Middle Easterners, aren't unloading the bullion they've amassed for investment purposes and he doesn't think they are likely to do so anytime soon. Their buying last year greatly contributed to silver's unprecedented rise.

Soaring prices haven't yet noticeably dented industrial consumption of the metal by the photographic, chemical and electronics industries, another factor contributing to the generally bullish outlook. Last year, industry used 410 million ounces of the metal compared with 404.5 million in 1978, according to Handy & Harman.

Pattern of Consumption

Still, 1979 consumption did steadily decline as prices rose, although analysts aren't expecting a dramatic switch away from silver usage this year, despite higher prices. The photographic industry, which accounts for about 30% of U.S. silver consumption, trimmed its usage sharply in 1974 when prices doubled to $6 an ounce. It isn't expected to install additional silver-saving measures, such as smaller frame film, until 1981, according to analysts at ACLI International Commodity Services Inc.

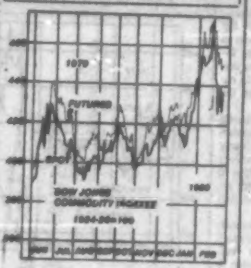
Possibly offsetting the metal's upward inclination is the increase of supplies expected to result from the recent meltdown mania. But it may take six months to a year for all that silverware to be transformed into marketable metal and it isn't clear what impact it would have on prices, analysts say.

They observe that for more than 20 years, world silver consumption has outdistanced new production; in 1979, total usage was 161.8 million ounces above production. The difference was supplied by sales from private stocks and bullion recovered from melted silver coins, silverware and scrap. New production isn't expected to increase appreciably.

Regardless of the impact of increased supplies on prices, exchange officials hope they will help revive silver futures trading. If greater supplies are available, the market would be less vulnerable to being cornered by large speculators and "there would be a viable silver market," contends Mr. Mintz, the Comex chairman. The Comex is considering reducing the size of a futures contract to 1,000 ounces valued at about $35,000 at current prices from its current size of 5,000 ounces valued at $175,000, a size prohibitive to most speculators, says Mr. Mintz. Most commodity contracts are valued at $20,000 to $30,000.

But, he isn't "sure this is the time to do it. It would be dangerous to get a lot of little guys in the market" at this time.

Commodity Indexes



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THE WALL STREET JOURNAL,
Monday, March 10, 1980

Commodities

Steps to Protect Silver Markets, Tarnished By Speculation, Are Sought by Officials

By ROBERT PRINSKY

Staff Reporter of THE WALL STREET JOURNAL

MIAMI, Fla.—In the aftermath of the big speculative buying that lifted silver prices to unprecedented heights and slowed silver futures trading to a trickle, commodity exchange officals are looking for ways to ensure their markets can't again be at the mercy of a few large traders.

Among solutions offered by participants at a Futures Industry Association conference here: monitoring markets more closely to detect buildups of large positions earlier; broadening exchange board memberships to ensure that special interests can't block action, and delegating more authority for surveillance to exchange staffs.

In the free-wheeling world of commodities, everyone knows that if exchanges can't control their markets, Washington will. "There isn't any excuse for manipulation to occur at all, and exchanges should be looking for mechanisms to provide assurance this doesn't happen," says James Stone, chairman of the Commodity Futures Trading Commission.

The CFTC's policy is to put the burden of market surveillance on the exchanges, and Mr. Stone says making this surveillance more effective is one of his major policy objectives. He favors limiting traders' market positions when delivery dates approach, altering contract terms when necessary to increase deliverable supplies and prevent a squeeze and broadening board memberships to represent all segments of markets.

In the past, the commodities business was largely closed, so all key participants knew each other, and if one trader got out of line the others leaned on him. Regulation still takes place essentially in this way in London.

But in recent years, U.S. markets have become more open. It has become possible for a small group of traders to amass huge quantities of silver futures without most members of exchange boards knowing who they are.

The pressure on silver as billions of dollars of the metal were purchased in part by unidentified Arab interests, "is larger than any previous congestion" of a commodity market, says Henry Jarecki, chairman of Mocatta Metals Corp., one of the bullion-trading firms whose finances were strained by the initial impact of big silver buying.

"Greater attention is going to be paid by exchanges to preventing manipulation," says David Johnston, senior vice president of E.F. Hutton & Co. and a member of the board of one of the two exchanges that has been struggling with silver, the New York Commodity Exchange, or Comex. Silver also is traded on the Chicago Board of Trade.

In retrospect, Mr. Johnston and other senior industry officials believe, the Comex acted too slowly in severely restricting silver futures trading to reduce the threat of a squeeze on deliverable supplies of the metal against contracts. They believe exchanges should monitor traders' positions more closely to enable earlier detection of potential problems.

The question then is who should deal with the problem. Customarily, this has been done by the membership of exchange boards, which usually is heavily weighted toward floor traders and dealers in the commodities concerned. Critics argue such boards will favor their members' positions at the expense of outsiders.

The Comex has the most balanced board of any exchange: seven members from each of the floor-trading communities, metal dealers and brokerage houses, plus three public directors. Lee Berendt, Comex president, suggests that all exchanges should have more public directors, but notes that the workload can be enormous. As the metals markets gyrated between September and January, there were more than 20 Comex board meetings, he notes.

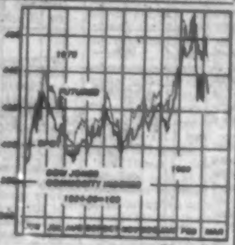
Outside directors can't be expected to assume such a workload, many officials believe. Neil Aslin, executive vice president of ContiCommodity Services Inc., says exchanges should behave like large corporations. "Boards should set general policy and delegate authority to professional staffs" to carry out policies such as the prevention of manipulation, Mr. Aslin says.

The Comex board has a broader makeup than the Board of Trade, which has 12 floor traders and only nine others, none of whom are metal dealers. In the case of silver, this produced slower movement by Comex to take strong action to limit trading.

Comex officials say they were anxious to avoid long-term damage to their market, which the Chicago exchange was apparently willing to risk. But analysts also note that influential members of the Board of Trade weren't involved, as influential Comex members were, making action politically less difficult for the board.

Indeed, the Board of Trade's trader-dominated board has many critics. Robert Wilmouth, the exchange's president, believes it should be broadened. "If we don't get a more diversified group, the CFTC will force it down our throats," he says.

Commodity Indexes



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The Washington Post

103rd Year No. 114 © 1980 Washington Post Co FRIDAY, MARCH 28, 1980 Subscription Rates See Box A2

Silver Collapses

Speculators Lose Millions of Dollars as Market Prices Plunge

By Jerry Knight and James L. Rowe Jr.
Washington Post Staff Writers

The silver market collapsed yesterday, costing speculators hundreds of millions of dollars and forcing federal authorities to take emergency actions.

The cash price of silver in New York plunged from $16.25 an ounce to $10.85, down 33 percent in 24 hours. Less than three months ago, silver was selling for $50 an ounce.

The biggest losers were two Texas billionaires, Nelson Bunker Hunt and his brother Herbert, who bought tons of silver last year, forcing prices to record highs.

Forced to come up with $100 million yesterday to cover their losses in the last two days, the Hunts began selling not only their silver but also their government bonds and their stock in several companies.

The Hunts' massive losses—on paper close to $4 billion since January—caused a financial crisis for their brokers, The Bache Group.

The Securities and Exchange Commission halted trading in Bache stock shortly after noon and quickly began investigating the silver-trading activities of the firm, the nation's fifth-largest broker.

Silent most of the day, Bache officials late in the afternoon issued a statement saying the company was financially sound and expected only negligible impact from the silver crisis.

Anxiety about the financial strength of Bache carried over onto other stockbrokers. Trading was also halted in the stock of publicly owned brokers Dean Witter Reynolds Inc. and Shearson Loeb Rhoades Inc. Both companies said they have little direct involvement in the silver market.

The stunning crash in silver prices caused what veteran analyst Newton Zinder called "a classic panic" in the stock market.

The Dow Jones industrial average plunged 23 points during heavy trading at mid-afternoon, then pulled back to within three points of its morning opening. Market analysts said the roller-coaster ride was due in part to heavy selling of stocks that the Hunt brothers are known to own.

The price of gold also fell sharply. It closed down $33.50 an ounce in New York at $463. On European exchanges, which close earlier, gold fell to $505.50 in London and $504.50 in Zurich. Prices of most commodities also fell sharply on U.S. futures markets.

But the value of the dollar increased dramatically, apparently because foreign investors believed the collapse of the silver market might ultimately be good for the American economy.

The dollar closed at 1.7905 Swiss francs, its highest in 20 months, and gained sharply against the West German mark and the Japanese yen. [Details on Page D1.]

At the end of the day, massive confusion still prevailed on Wall Street about what was happening in silver. There was general agreement, however, that silver's problems could affect both the stock market and the entire economy.

"From an economic standpoint, one of the last inflationary bubbles has been burst," said Michael Metz, vice president of Oppenheimer and Co. and a respected market analyst.

"All the speculative fluff is out of the stock market," added Metz. "Next comes real estate."

See SILVER, A14, Col. 3

Area dealers and sellers caught by sudden plunge Page A15

NELSON BUNKER HUNT
. . . compelled to sell stocks, bonds

Silver Market's Plunge Costs Millions

SILVER, From A1

Calling the collapse of the silver speculation "profoundly satisfactory," he said, "almost every speculative game in town has proven fatal of late. Maybe people will go back to old-fashioned savings accounts, which would be a tonic for the economy."

Lessons learned from the silver market, other economists said, could cool the speculative fever in the economy that has fanned the fires of inflation.

Speculation based on the premise that inflation will continue indefinitely has drained away investments that otherwise would have built homes and factories that contribute to economic growth.

The fall of silver prices from their unprecedented highs finally shows that the forces of supply and demand are ruling the market again, said Walter Frankland, head of the Washington-based Silver Users Federation.

Since last August, when silver was selling for $9 an ounce—only a little less than it is now—prices have had nothing to do with the normal silver trade, he said.

"As to what has gone on today," Frankland said, prices came down for two reasons:

- An unprecedented amount of silver was produced by "secondary sources," refiners who melt down old coins, trophies, even teeth to get the metal. There's now a six-month backing of unmelted scrap silver, several times as much as normal.
- Other investments became more attractive than silver speculation when the price began falling, after hitting the $50 mark on Jan. 21. A 13 or 14 percent return on money market investments was safer than the potential profits of silver hoarding.

Cash prices for silver have come down so fast that they have dropped below prices in the futures market, which usually sets the pattern for cash sales. Futures contracts are agreements to buy or sell 5,000 ounces of silver at some future date.

Under commodity exchange regulations futures prices can go up or down only $1 a day. When the markets opened yesterday, the first bid was down the limit and the same thing is expected to continue until futures prices come close to cash levels.

The Commodity Futures Trading Commission, which polices those markets, held two emergency sessions yesterday and called another for this morning.

The commission unanimously agreed to keep the silver market open and to take no immediate action to curtail trading.

The CFTC refused to disclose what other actions it was taking. Industry sources said federal regulators are looking into the silver dealings of two other large firms, Conti Commodities, a subsidiary of the giant Continental Grain Co., and ACLI International, a commodity firm headed by Adrian C. Israel, the chairman of the board of People's Drug Stores of Washington.

CFTC officials said the government has no obligation to step in to protect silver speculators from losses, but might act if brokerage firms appear to be having troubles that endanger their customers.

CFTC Chairman James Stone met this week with Federal Reserve Board Chairman Paul Volcker, who has repeatedly expressed concern about excessive speculation and its damaging effect on the economy.

The Federal Reserve's efforts to control inflation by raising interest rates and discouraging banks from making speculative loans also may have helped burst the silver bubble. The high cost of borrowing money to play the silver market has discouraged many speculators, and even the fabulously wealthy Hunts have had trouble borrowing money.

Two days ago Nelson Bunker Hunt announced in Paris that he and other silver speculators planned to sell bonds backed by silver.

What apparently was a last-ditch effort to raise money to finance their silver holdings.

The New York Stock Exchange called an emergency meeting to assess the financial strength of its members. None of the brokers appears to be in trouble, said a person who attended the session.

Under market rules, the broker is liable for a customer's losses and must settle up for all losses every day.

To ease the pressure for cash, the New York Commodity Exchange, the primary silver market, reduced on Wednesday night the amount of money required to hold a futures contract for silver.

Comex acted after discovering that ContiCommodities customers were down $100 million for the day, Bache was short $100 million for the Hunts alone, and other brokers, including Merrill Lynch, Pierce, Fenner and Smith, had to come up with multimillion-dollar [illegible] to cover losses in silver.

When the price drops $1 a day, on a 5,000-ounce contract, the speculator must come up with an extra $5,000. The Hunts reportedly held more than 20,000 contracts, producing losses of $100 million a day.

Bache officials confirmed that the Hunts were told Tuesday night that they needed another $100 million by yesterday. For the first time, the Hunts refused to pay, and Bache proceeded to sell their silver contracts and other investments pledged as collateral.

The sales apparently produced enough money to cover the Hunts' $100 million loss and also to protect Bache, which has a net worth of $130 million.

Contributing to this report were staff writers John F. Berry and Peter Behr.

March 28, 1980

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Silver Drop Shakes Hunts' Empire, Leading to Turmoil on Wall Street

Associated Press

Nelson Bunker Hunt

Fears of a Metal Sell-Off Depress Stock Prices and Pose Threat to Broker

By STEVE LOHR

The plummeting price of silver yesterday shook the enormous, $2 billion silver empire of Nelson Bunker Hunt and W. Herbert Hunt of Dallas, pressing them to raise millions of dollars in cash and throwing Wall Street into a furor.

Fears of a headlong sell-off in silver and the possible collapse of the Hunt empire sent the Dow Jones industrial average down more than 25 points at one point in hectic trading of more than 60 million shares. [Page D1.]

The upheaval threatened at least one major brokerage house, prompting Government intervention to prevent stampede selling in its shares and driving the price of silver still lower. Silver closed the day at $10.80 an ounce, down $10.82 from Wednesday's price and far below its January high of $50.05.

Margin Calls Touched Off

The tumult was touched off by a sharp fall in silver futures prices Wednesday, which generated a flurry of margin calls by brokerage houses, requiring investors who bought silver on credit to put up more cash to maintain their equity in their holdings. Investors routinely buy silver and other commodities largely on credit, or margin. Margin is a down payment of a small percentage of the total purchase price.

Hardest hit were the Hunt brothers, who since last summer have built up silver holdings of more than 200 million ounces. Their widely publicized purchases of silver helped push its price up from $6 in early 1979. According to bankers and silver traders, at least some of these purchases were made on credit.

With falling silver prices and soaring interest rates, their hoard has become all the more costly to carry. Apparently strapped for cash, the Hunts reportedly were forced to sell some of their securities holdings to raise money on their silver futures positions.

Classic Pinch Seen

According to traders, the Hunts were caught in the classic pinch. If they sold silver to raise the needed cash, they faced the near certainty of driving down the price still further and touching off a snowballing process. By market accounts, the Hunts have lost more than $1 billion in recent weeks.

Equally hard pressed was Bache Halsey Stuart Shields, a brokerage firm that has been the Hunts' silver brokers for years and that is 5.6 percent owned by the Hunts.

A Bache spokesman said the Hunts had failed to meet the margin requirements first imposed late Tuesday, and that the firm had proceeded to liquidate some of the Hunt silver holdings to meet the margin calls on Wednesday morning.

"We've been dealing with the Hunts

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Silver Slump Hits Hunts And Upsets Wall Street

Continued From Page A1

for about eight years, and Tuesday of this week was the first time they didn't meet one," said Elliot J. Smith, executive vice president of Bache.

Mr. Smith said that, in accord with the policy of his firm, the Hunts were informed by telephone Wednesday morning that, unless the position were covered, Bache would begin liquidating some of their silver holdings. "They said they were not sending money or collateral," Mr. Smith said.

Apparently as a result of the liquidation, the margin debt by the Hunts to Bache Halsey Stuart Shields currently stands at about $100 million, down from more than $200 million a few days ago, according to Wall Street sources. "That's about right," said one Bache executive, who declined to provide any other details.

Mr. Hunt could not be reached for comment yesterday.

Trading in Bache Suspended

In an unusual afternoon action, the Securities and Exchange Commission yesterday suspended trading in the Bache Group Inc., the parent company of the brokerage house, because of "undisclosed material corporate events relating to commodities futures trading accounts maintained by customers with the firm."

Although commission officials would provide no further details on that action, the statement clearly referred to the Hunts' failure to meet their margin call.

Underscoring the urgency of the Hunt situation and the possible effect on the financial markets, the Government decision to suspend trading in Bache took place at an unusual emergency meeting of top S.E.C. and Treasury Department officials yesterday afternoon. The circumstance of the session also reflects the unexpected nature of the problems surrounding the Hunts' financial pinch.

The officials who made the decision included Harold M. Williams, commission chairman; Irving M. Pollack, an S.E.C. commissioner, and Theodore A. Levine, associate director of the commission's enforcement division. They had been attending a scheduled conference on corporate governance in Williamsburg, Va., at a state-run facility there, sponsored by a lawyers' group.

But as news of the Wall Street situation reached them, these top Government officials left the conference and met in a small, windowless room. At this closed-door session, they debated what to do and decided the situation warranted a halt of trading in Bache, which occurred at 2:15 P.M.

The Commodity Futures Trading Commission, which oversees trading in futures contracts, met twice yesterday to consider curbing silver futures trading but after a late-afternoon session decided not to act immediately. Instead, it scheduled a midmorning meeting for today.

Late last night, Bache requested a meeting with the futures commission at which it intends to ask for a suspension in silver trading, officials of the Commodity Exchange Inc. reported. The concern about the financial health of Bache, and other brokerage firms with which the Hunts held accounts, results from exchange and governmental regulatory requirements on margin accounts. These accounts allow clients, in effect, to borrow from the brokerage firms to buy commodities or securities on margin.

The margin account must be backed up with collateral, usually either in commodities or negotiable securities of some type. The underlying collateral must be kept at a given percentage of the total holdings of a client, such as the Hunts. When the market price of the collateral declines, the brokerage house places a margin call to the bearer of the margin account, telling him to send in more collateral to maintain the required percentage of collateral backing.

In the Hunts' case, part of the underlying collateral was actual silver. So when the Hunts told Bache they would not meet that margin call, the firm began liquidating part of the silver holdings it held for the brothers in order to pay the exchange the additional money required to maintain ownership of the silver as its price fell.

The New York Times/George Tames

Harold M. Williams, chairman of the S.E.C., leaving meeting in Williamsburg, Va., before deciding to halt trading in Bache Group stock.

Wall Street Rocked by Silver

By WINSTON WILLIAMS

The turmoil in the silver futures market yesterday sent tremors through Wall Street.

Before calm was restored in late afternoon trading, the Securities and Exchange Commission suspended trading in the issues of one major brokerage house. Trading was also stopped in another, but not by S.E.C. action.

Bond prices remained relatively firm as investors sought refuge from the explosions in other markets. But silver's $5 plummet, to $10.80 an ounce, was accompanied by substantial drops in gold and copper prices. Sugar, cotton, cattle and hog prices dropped as much as commodity exchange rules allowed. And the Dow fell by as much as 25 points before recovering in late afternoon.

"A classic panic," was the way Newton Zinder, market analyst for E.F. Hutton, described the activity in the stock market. "People were just dumping stocks at any price. Rumors are flying all over the place about who might be hurt," he added.

The frenzy began when the S.E.C. halted trading in the shares of the Bache Group, the parent company of Bache Halsey Stuart Shields, which is partially owned by the Hunt family. Bache also said that a continued decline in the price of silver could have a negative impact on the company's financial position.

Widespread Impact

Nearly everyone associated with the Hunts or silver felt the impact. Trading was also suspended in the shares of Shearson Loeb Rhoades and two other securities firms — Dean Witter Reynolds and Paine Webber — came under heavy selling pressure. The surveillance committee of the New York Stock Exchange called an extraordinary evening meeting to discuss the finances of member firms.

Silver Futures Turmoil Affects Other Markets

By MICHAEL QUINT

NEW YORK — Problems in the silver futures market spilled over into other financial markets on Thursday, and prices of Treasury bills rose sharply as investors and securities firms sought the highest quality, most liquid securities available.

At a time of vast unknowns, some market analysts conclude that the central bank is unlikely to pursue further tightening of policy, at least until more is known about the situation. Others say it is not possible to predict the ramifications of the silver market and said that widespread crises need not result. They noted that Federal funds traded over 19% most of Thursday.

Thursday afternoon, Bache Group, Inc., announced that some of its customers had failed to meet substantial margin calls and added that the continuing decline in the silver markets could have a negative impact on Bache's financial position. Wall Street sources said that Nelson Bunker Hunt and W. Herbert Hunt have been attempting to borrow large sums of money needed to meet margin calls. News reports that the Hunts were

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Securities

Silver Futures Turmoil Affects Other Marts

(Continued from page 1)

selling common stock holdings and the general uncertainty in the marketplace contributed to a sharp decline in equity prices Thursday, which was largely recouped by the close.

First Chicago Corp. was the most active stock on the New York Stock Exchange Thursday at 1.083 million shares traded. The stock closed at 11½, down one point on the day. It was rumored that First Chicago was one of the stocks being sold by the Hunt family, as they sought to raise cash to satisfy margin calls due on their silver futures contracts. Bank officials had no comment on the Wall Street rumors.

If it is true that the Hunts have had difficulty meeting margin calls on their futures contracts, market observers say that is one visible sign of the Federal Reserve's tight money policy. On Wednesday, Bunker Hunt announced a plan to sell silver-backed, interest-bearing certificates. Already the Hunt family has liquidated a large portion of its silver position, observers say. Late Thursday, it was reported that the remaining Hunt position in silver contracts at Bache had been liquidated.

Fed Adds Reserves

While the debt markets were digesting the news from the silver market, Federal funds traded over 19% most of Thursday. Funds were over 19% even after the Federal Reserve added reserves to the banking system via four-day repurchase agreements. Some observers now say that the Fed's growth objectives for bank reserves translate into a funds rate over 18%. Some analysts predict a money-supply bulge this spring and say that the excessive money growth would prompt the Fed to lower its growth targets for bank reserves.

Others, however, predict that financial shocks, such as that in the silver market, could contribute to a quicker, more severe recession than anticipated. If that develops, a brief surge in business credit demands would be followed by a decline in credit demands and lower interest rates, they say. Furthermore, they say the central bank is not about to continue tightening policy while the markets are embroiled in any controversy.

Demand for Treasury bills was strong enough Thursday to reduce bid rates to 15%, 15.1% and 14.15% for new three-, six- and 12-month issues. Early in the day the same issues were bid at rates of about 15.8%, 15.55%, and 14.45%. The new one-year bills were auctioned Thursday at an average rate of 14.459%. Bond equivalent yields are about 16.50%, 16.39%, and 15.96%.

Elsewhere in the money markets, rates increased slightly, but market conditions were not chaotic. Analysts said that while prices of Treasury bills were bid up sharply late Thursday, financial pressures did not intensify in the commercial paper or certificate of deposit markets.

In the CD market, for example, domestic six-month CDs were bid by dealers at about 16.20% late Thursday compared with 18.05% early in the day. Among banks active as issuers, observers said that 18% is still the most paid for a six-month issue. In the one-month area, CDs are issued at about 16¼%. High grade paper due in 30 days was sold by dealers at about 16⅜% Thursday.

Treasurys Higher

In the Treasury coupon sector, prices were generally higher Thursday. Some participants cited statements by Treasury Secretary G. William Miller than Treasury borrowings will decline sharply after April 15. The balanced fiscal 1981 budget will mean a drastically reduced presence for the Treasury market, he said.

Some analysts were skeptical of the Treasury official's comments. At Bank of New York, economists noted that the revisions in fiscal 1981's budget "will provide the markets only a minor respite in terms of the projected volume of Treasury finance. Off-budget finances will accelerate next year, they said, while cash requirements will grow due to redemptions of nonmarketable debt by foreign central banks and investors in Savings Bonds. Furthermore, the offerings of coupon issues will remain heavy as the Treasury continues to lengthen the average maturity of its debt.

Among recent, actively traded issues, the 15% notes due in two years were offered late Thursday at 100 16/32 to yield 14.70%, compared with a low of 99½ earlier in the day. The new 14⅛% notes due March, 1984, were offered at 101 24/32 or more than a point above Wednesday's close. Both issues are being traded on a when-issued basis.

The Treasury's 10⅜% bonds due 1995 were offered at 85½ to yield 12.68% and the 11¾% bonds due 2008 were offered at about 95½ to yield 12.37%.

Prices of tax-exempts declined further in the last week to raise yields to record high levels. The Bond Buyer's 20-bond index rose 24 basis points to a record 9.44%, and the 11-bond index increased 29 basis points to 9.04%. The 30-year revenue bond index rose 20 basis points to 10.19%. ■

The Washington Star

Business & Finance

Monday, March 31, 1980

CFTC Launches Probe Of Silver; Could Take Disciplinary Actions

By Sheilah Kast
Washington Star Staff Writer

The chairman of the Commodity Futures Trading Commission said today his agency has begun an investigation of silver trading that could lead to disciplinary actions or the barring of some traders from the market.

James M. Stone disclosed his agency's plans in testimony before the House Commerce's consumer and monetary affairs subcommittee which has begun hearings on last week's silver collapse.

Rep. Benjamin S. Rosenthal, subcommittee chairman, sharply questioned Stone about whether his agency had done enough to avert last week's turmoil in the silver market.

When silver prices plunged midweek to less than $11 an ounce and the millionaire Hunt brothers of Texas refused to put up larger down payments, or margins, on their silver positions, many of their holdings were liquidated by their brokers. The situation raised fears that other markets would plummet.

Meanwhile, the Bache Group Inc. today said it faces the possible loss of $50 million from silver accounts maintained by the Hunt family, but said the firm still had adequate capital to continue in business. The statement contradicted one issued Friday that Bache had liquidated the Hunt accounts at no loss to itself.

Even after some of their silver holdings were liquidated last week, Nelson Bunker Hunt and W. Herbert Hunt still control more silver than the total amount used in the United States last year, Rosenthal said. The Hunt brothers control between 150 million and 200 million ounces of silver, compared with a total domestic consumption last year of 166 million ounces, Rosenthal said.

Stone argued today that Congress has not given his commission the legal tool it most needed to avert last week's events. "The tool that would have been most useful, if we were afraid of a cache-hording situation would have been to *raise* margins," Stone said.

The margin is the down payment an investor makes. Raising margins makes it more difficult for investors to horde large amounts of a commodity.

Rosenthal questioned whether the commission took the Hunts' dominance of the market seriously enough. But Stone said the commission began "jawboning" the commodities exchanges to put more limits on investors, and some of the exchanges took such actions late last year.

Over Stone's objections, Rosenthal played a tape recording of a closed CFTC meeting last July 27 where several commissioners laughed about the possibility that the Hunts were dabbling in silver and other commodity markets the way less-wealthy people play Monopoly.

Commissioner David G. Gartner said, "It just seems to me they are people with a hell of a lot of money and not a lot to do with their time, fiddling around like you and I might play a game of checkers."

A staff member told the commissioners that the Hunts then held about $475 million dollars worth of silver futures contracts. This was before silver prices started rising last September, eventually hitting $52 an ounce in January.

Marginal Effects

Silver's Slide Bloodies Only Hunt Brothers, And They're Unbowed

They May Rethink Strategy; Their Buying on Credit Is Cited in Rise and Fall

House Hearings Open Today

THE WALL STREET JOURNAL, Monday, March 31, 1980

A WALL STREET JOURNAL *News Roundup*

Everybody knows that the silver-buying Hunt brothers have a lot of money—billions of dollars, in fact. But except for a relatively few insiders, most people didn't know—until late last week—that the Hunts also owed a lot of money. The public learned about the loans through a crash course in the silver market.

On Wednesday, the price of silver for current delivery on the New York Commodity Exchange dropped $4.40 an ounce, and on Thursday, it plunged another $5, to $10.80. Those declines, moreover, weren't just a two-day phenomenon. They were the culmination—at least, so far—of a sickening slide from a Comex record price of $50.35 an ounce in late January.

Watching that slide with more-than-casual interest were Nelson Bunker Hunt and W. Herbert Hunt, two of the four sons of the late H.L. Hunt, the Dallas oilman. They had begun a silver-buying spree late last summer on futures exchanges in New York and Chicago. Eventually, the Hunts acquired an estimated 120 million ounces of silver bullion and at least 50 million ounces in futures positions.

Taking Delivery

As the Hunts' buying helped push up the price of the metal, they bought more and more futures contracts. Like everyone else in the futures market, the Hunts bought on margin—putting up only good-faith money in, initially, modest amounts compared with the size of the contracts.

But the Hunts also did something unusual: They took delivery of the metal rather than simply evening up their positions before contracts expired—the normal practice for commodities speculators. By thus removing the silver bullion from the market, they stirred fears of a shortage and helped accelerate the surge in prices. Then, according to knowledgeable observers, they used the profits that they were making on their remaining futures positions to buy more bullion and more futures contracts.

"There would be no problem in the market if the silver had not been financed," says an official of a large brokerage house. He explains what happened in this way: "When the markets kept going up, the borrowing kept going up proportionately with it. As the Hunts took more and more silver off the market and hoarded it, they used that silver to borrow more money to buy more silver, which drove the market higher, which created more money to buy the same quantity at a higher level."

Getting Nervous

Although the Hunts weren't doing anything illegal, their buying—along with big purchases by four Arabs—was beginning to make many observers nervous. "A lot of us certainly were expecting the market to crash for months," says John Coffin, head of commodities trading for Drexel Burnham Lambert Inc. "Time after time, there are people who think they can control markets. Inevitably, they lose control of the market and they lose their shirts."

While the value of the Hunts' holdings has declined billions of dollars, they haven't lost their shirts. In fact, they don't seem to have lost much, if any, money because they are believed to have bought their silver at less than $10 an ounce and thus are still ahead of the game. Furthermore, they got past another potentially dangerous day on Friday, when the price—rather than falling again, as some observers feared it might—edged up a bit to close at $12 an ounce on the Comex.

Also apparently riding out the storm successfully are the brokerage firms—particularly Bache Halsey Stuart Shields Inc.—that were heavily involved with the Hunts. Bache Group Inc. announced on Friday that its brokerage-firm subsidiary had sold off, without any loss to itself, all the silver bullion that it had held as collateral for the Hunt futures contracts. Bache Group added that its capital position remains unimpaired. Furthermore, both the parent company and Harold Williams, chairman of the Securities and Exchange Commission, say they expect trading in Bache Group's own stock, which was suspended Thursday, to be resumed today.

"No Problems at All"

At the Chicago Board of Trade, Robert Wilmouth, president, said auditors have been examining the books of several member firms, and he expressed "confidence that there will be no problems at all" with their financial positions. Similarly, a spokesman for the Federal Reserve Bank of New York said that "at this point, I have no information that would lead to any concern about the safety or soundness of any bank."

Perhaps surprisingly, few small traders in commodities got hurt in the wild two-day plunge in the price of silver last week. "Most of the damage was done to the people who ran it up to $50," one trader says. "None of the little guys could afford to be in the market" by last week because the margin requirements had been pushed so high.

Even the Hunts themselves are said to be unworried. The two brothers weren't "psychologically or otherwise" shaken by last week's gyrations, said Ivan Irwin, a Hunt family lawyer in Dallas.

"It didn't do anything to dampen their belief that silver is a very good long-term investment," Mr. Irwin said Friday afternoon. "The Hunts have long believed and still do that silver is a depleting resource of

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the earth and is bound to increase in value. That belief hasn't been shaken at all."

The attorney did indicate, however, that the turmoil may cause the Hunts to "rethink" their silver-trading strategy because, he added, recent government restraints have created an "illiquid market." He said that for the near future, the Hunts "don't plan to trade in (U.S.) silver futures until there's a true silver auction place that isn't encumbered by government regulation." A similar statement was made by Nelson Hunt in late February.

For its part, the government apparently is about to look into the turmoil in the silver market. Today, for instance, a House subcommittee plans to question James Stone, chairman of the Commodity Futures Trading Commission, and SEC Chairman Williams. Mr. Williams, however called the hearings "premature" and complained that the SEC still hadn't figured out exactly what happened last week or what the problems were.

The first hints that problems might lie ahead surfaced in late August, when it became known that Conti-Commodity Services Inc. was buying heavily on behalf of Najib Nahas, a wealthy Arab resident of Brazil, and other Arabs. In September, the fact that the Hunts also were buying leaked out, although—unknown to the public—they had been in the silver market ever since 1973. Other speculators were attracted to the market, and the price of silver surged to a then-record $18, nearly triple the quote at the beginning of 1979.

Also in September, a number of brokerage houses, including Drexel Burnham Lambert, stopped taking speculative orders in silver futures because of the risks involved. Furthermore, qualms about the Hunts' trading had set in even earlier. George D. F. Lamborn, senior executive vice president and director of commodities for Shearson Loeb Rhoades Inc., says that the firm hasn't done any business with the Hunts since last June because the brothers wanted to trade on too thin a margin.

The amount of margin is important in futures trading because it is the amount of money that traders must put down with their brokers to trade in futures. Normally, the margin is low—about 5%—of the contract's value. If there is a drop in the price of the futures contract—which is an agreement to deliver or receive a specified quantity of a commodity at a specified price, time and place—the trader has to put up more money quickly. It he doesn't, the broker avoids a loss to the firm by selling the customer's contract.

Marginal Effects: In Silver's Big Slide, Only the Hunts Seem Bloodied, and They Are 'Rethinking' Strategy

Charge of the Silver Bulls

In the early fall, the nation's two silver-trading markets began a series of attempts to curb speculation. The Comex raised its margin requirements to $20,000 for each 5,000-ounce contract from $1,000, and the Chicago Board of Trade limited the number of contracts that any one speculator could hold.

Despite these restrictions, the bull market in silver raged on. In early October, Paul A. Volcker, chairman of the Federal Reserve Board, began making a series of requests that banks not make loans for speculative purposes. But the Fed's Oct. 6 credit-tightening package slowed the rise in silver prices for only a few days. Traders explain that few people take out loans to get their margin money, and government officials say the Hunts probably bought most of their silver futures with profits generated daily by the metal's rising price. "As they rode this thing up, they were getting huge payouts," one official says. Looking back, an official says, "I'm not sure what the Fed could have done" to prevent the eventual crisis.

By late January, silver reached a record $50.35 an ounce, and margins were raised as high as $60,000 a contract. Most small speculators abandoned the market. But the big guns stayed on, backed, says an official at a major brokerage firm, by "a few firms that thought they had enough money to ride this thing through. At the top of the market, there wasn't anybody left to sell the stuff to."

In addition, soaring interest rates—brought on by the Fed's campaign against inflation—halted the boom in commodities prices. High interest rates made other investments more attractive, and the initial effect of the crises in Iran and Afghanistan—which had contributed to the gold and silver mania—had worn off.

The Price Falls to $20

By the beginning of last week, the price had slumped to $20. As the quote had dropped all the way from $50, the Hunts and other big speculators had been paying in more margin money, which is due at the end of every trading day.

Much of that margin was paid in the form of silver bullion. But by last week, one observer says, "the Hunts wouldn't or couldn't come up with any more bullion." Bache, the broker that was handling much of their silver business, became worried that the firm itself might be dunned for $100 million of needed margin.

Bache representatives asked the Comex board whether silver margins could be lowered, so as to reduce the firm's liability. Late last Wednesday, the Comex did cut the requirement by $10,000 a contract—to $25,000 a contract for holders of one to 10 contracts and to $40,000 for holders of more than 100 contracts.

But commodity traders already had found out that the Hunts were being forced to sell their silver to meet margin requirements. "Visions of a market flooded with silver danced through everyone's heads," one trader said.

So, on Thursday, the market began to drop sharply as traders bailed out. To meet the Hunts' margin calls, Bache was forced to sell the Hunts' bullion that the firm had been holding, observers say. The sell-off spilled over into the stock market, where active trading in stocks that the Hunts were known to hold aroused widespread suspicions that the family was scrambling to raise cash to meet the silver margins. Besides, the stock market was vulnerable anyway, after sliding for weeks and facing many nagging uncertainties about the economic outlook.

By this time, officials in Washington were monitoring events closely. Fed Chairman Volcker, for example, was described by one insider as "doing nothing else" much on Thursday.

Responding to rumors that various Hunt family interests are liquidating large positions in various securities, William Herbert Hunt said in Dallas: "From time to time, various Hunt interests buy and sell commodities and/or publicly held stocks. These Hunt interests operate independently of one another." In a similar vein, C. D. Brown, president of Placid Oil, denied reports that the private concern, owned by trusts set up by H. L. Hunt, was selling all its shares in Gulf Resources & Chemical, Louisiana Land & Exploration and other companies.

William Herbert Hunt also complained that the family's "difficulties" in silver have been "caused by overregulation of this commodity" and that "these problems result from changing of rules relating to trading limits and from imposing unreasonable and unrealistic margin requirements."

Similar complaints were voiced by Bache, which blamed the slump in the silver market partly on the "artificial restrictions" imposed earlier by the Comex to slow down the price increases. The brokerage firm, in fact, sought to alleviate its problems by getting the Commodity Futures Trading Commission to suspend indefinitely trading in all silver futures and to order liquidation of all silver-futures positions at a fixed price. The Bache executives argued that the market was facing an "emergency."

But early on Friday, the agency's four commissioners unanimously denied the petition. "If we suspended trading today (Friday)," Commissioner Robert Martin said, eventually the commission has "got to reopen it," and then "a later problem" would be created. Besides, Chairman Stone added, the commission's "primary job . . . is to protect small customers" and not to bail out large traders. He assured small investors that "they will be protected."

The Hunts, however, are believed to have sustained a drop of $500 million to $600 million in their accounts at Bache alone, and the plunge in silver prices is estimated to have put a $1 billion dent in their holdings overall. Nobody knows how much silver they may have left.

The Hunts' collateral at Bache consisted of Treasury bills, securities and silver bullion, and they were sold off, in that order, between last Tuesday and Thursday to meet the margin call. The firm's capital position never got as low as 7% of aggregate debts—at which point, under Big Board rules, a concern can't take on any new business. But there was a danger late Thursday that if silver prices didn't improve on Friday, the Bache capital position could have dipped below 7%. Bache then would have had either to stop taking on new business or to obtain additional capital. The danger arose because, after all the collateral had been sold off, Bache started to liquidate the Hunts' silver futures contracts. And if those contracts hadn't fetched high-enough prices, Bache's capital position would have been impaired.

Some other brokerage firms also went through a tough period last week. A. G. Edwards & Sons Inc., of St. Louis, for example, disclosed on Friday that a customer, which the firm wouldn't identify, couldn't meet a margin call on silver futures. The account has been sold, and a $4 million deficit has been charged against Edwards' capital.

"A Nasty Punch"

"It's a nasty punch in the nose to us," says Benjamin F. Edwards III, president and chief executive officer of the firm, "but it won't in any way make it tight for us. We still have $22 million excess capital after the $4 million charge." He adds: "We hope we can find some assets and legally attach them." Another Edwards official says the firm believes "it's a liquidity problem" rather than an inability to pay the debt, and he indicates that he expects the debt to be paid.

Similarly, Paine, Webber, Jackson & Curtis Inc. said it liquidated two "large" commodities accounts because of their failure to meet margin calls. James W. Davant, chairman of the firm's Paine Webber Inc. parent, said the accounts had a total deficit of $18 million after the liquidations. The official declined to name the accounts, but they are understood to have belonged to the Hunt brothers.

As a result of such problems, some people are suggesting that commodities regulations be tightened. Mr. Edwards, for example, says he will ask the Securities Industry Association to consider recommending tighter margin rules to the SEC and the commodity commission. And Chairman Stone himself says he will have the commission staff "study the adequacy of present position limits and margin requirements" for all futures trading.

But some traders think that the silver market won't recover soon. "Public confidence in the market has been lost," one analyst says.

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Hunt Silver Dealings Nearly Cost Engelhard Minerals $400 Million; Bache Expects to Recoup Its $50 Million

House Subcommittee Grills U.S. Regulators of Stock, Commodities Exchanges

A WALL STREET JOURNAL News Roundup

The silver market turmoil started by the Hunt family's problems last week continued as Engelhard Minerals & Chemicals Corp. narrowly missed losing $400 million.

Separately, Bache Group Inc. disclosed that its losses from its Hunt trading may total as much as $50 million, although Bache said that $17 million had been repaid and that it has assurances from the Hunts that the remaining $33 million will also be paid back.

And, in Washington, a House subcommittee probing the silver tumult grilled government stock and commodities markets regulators, who announced their own investigations of the Hunts, Bache and the metals market.

Engelhard Minerals earlier this year had agreed to sell the Hunts 19 million ounces of silver at approximately $35 an ounce, or a total of $665 million.

Since then, however, silver prices have fallen as low as $10.25 an ounce, making the agreement financially undesirable for the Texas billionaires. Silver for current delivery closed at $14.20 an ounce, on the New York Commodity Exchange yesterday, giving the 19 million ounces of silver a value of $269.8 million, or about $400 million less than the original $665 million. The sharp drop in silver prices raised fears that the Hunts would back out of the contract.

Oil and Gas Interests

Yesterday, in lieu of the original agreement, Engelhard said it signed a preliminary accord to cancel the contract in exchange for 8.5 million additional ounces of silver and interests in major Canadian oil and gas properties in the Beaufort Sea.

Engelhard said the additional silver plus the oil and gas interests "approximate in value" the difference between the $269.8 million current value of the 19 million ounces of silver and the contract sales price of $665 million. With the new agreement and the 19 million ounces of silver, which Engelhard will retain, the company will avert the $395.2 million loss.

Thus, Engelhard appears to have escaped the fate of Bache, whose dealings with the Hunts caused it some nervous moments last week. Short of cash, the Texas family failed to pay Bache some $100 million due on its margin accounts, forcing Bache to sell the silver bullion it held as collateral from the Hunts. A margin is the money which must be put down to enter into a futures contract.

Clyde Mosnie, Engelhard executive vice president, said in an interview that the company didn't fear that the Hunts would renege on their agreements. "They continually said they would honor their commitments and we saw nothing to the contrary, though we did read in the papers they were in a cash bind."

WSJ APRIL 1, 1980

Will Engelhard, following its receipt of the 8.5 million ounces of silver, as well as the 19 million ounces of retained silver, unload those 27.5 million ounces on the market, possibly driving silver's price down?

Mr. Mosnie indicated that the concern wouldn't flood the market with its silver. "We aren't under any financial constraints to do anything under duress," he said. "The silver is in the hands of experienced traders who are accustomed to holding large positions."

"Even if the Hunts had defaulted, it wouldn't have had a major impact on us," Mr. Mosnie said. "We have financing to cover ourselves even for these kinds of amounts."

Bache said yesterday that the $50 million debt consisted of $30 million owed to two metals trading units—Bache Halsey Stuart Metal Co. and Bache Halsey Stuart London Ltd.—and $20 million owed to Bache Halsey Stuart Shields Inc., a securities subsidiary through which the Hunts did most of their silver speculating.

Of the $17 million repayment, $10 million has gone to satisfy the debt at the securities firm, and $7 million has gone to the metals units, Bache Group said.

The parent company added that, even had the $20 million loss been fully absorbed by the securities unit, the subsidiary still would have been in compliance with New York Stock Exchange capital rules. The metals subsidiaries aren't supervised by the Big Board.

Separately, Bache Group also disclosed yesterday that the Hunts currently own about 100,000 more Bache Group shares than was earlier publicly known. The company said the Hunts currently own 560,000 shares, or 6.5% of the company's 8.6 million shares outstanding.

In Washington, the Securities and Exchange Commission disclosed that it has begun an investigation of the Hunts' stake in the brokerage concern that was most threatened by their heavy silver speculation.

SEC Chairman Harold Williams disclosed his agency's action in testimony yesterday before a House subcommittee that is looking into the reasons for the near-debacle in silver.

Mr. Williams wouldn't say whether he believed the Texans' holding in Bache Group created a conflict of interest for the securities concern. But he indicated that the SEC's investigation could produce "specific" actions — presumably, enforcement proceedings, against Bache, the Hunts or both. Or, it might lead the commission to conclude that its existing regulations don't cover the Hunts' interest in Bache and that additional regulations are needed, Mr. Williams suggested.

Mr. Williams's comments came during a morning of critical and sometimes caustic questioning by members of the House Commerce, Consumers and Monetary Affairs Subcommittee. Both the SEC chairman and the other witness at the hearings, James Stone, chairman of the Commodity Futures Trading Commission, acknowledged that events leading up to last week's crisis demonstrated the need for improving government regulation of commodities trading.

Mr. Stone was less reticent than Mr. Williams about the approximately 560,000-share interest held by Herbert Hunt and Nelson Bunker Hunt in Bache Group. "There is a conflict-of-interest problem when a very large customer of a firm also is a large stockholder of that firm," he told the subcommittee.

In New York, a Bache spokesman denied the conflict-of-interest allegation. "I can categorically tell you that the Hunts never asked for any preferential treatment and they were never given any."

Mr. Stone told the House subcommittee that the CFTC currently may be "in a situation where our tools aren't adequate" to prevent such debacles as last week's silver market turmoil. The CFTC chairman noted that when Congress created his agency in 1974, its primary concern had been to correct abuses in the markets for agricultural commodities.

Open to Amendments

The subcommittee doesn't have legislative jurisdiction over the CFTC and any moves to expand the agency's powers would be up to the House and Senate Agriculture Committees. A staff member of the House Agriculture Committee said his panel would be open to CFTC recommendations for amendments to its act.

The CFTC apparently has a good deal of existing authority, though. Mr. Stone told the committee that his agency also has begun an investigation into silver trading. He didn't provide any details but said one possible outcome is "disciplinary action that could conceivably bar an individual or firm from the market."

During the hearing, the commodities agency came under heavy fire for having done little to restrain silver speculation before last week's tumble. Rep. Benjamin Rosenthal, the subcommittee chairman, charged that the commodities "commission was sitting by while the Hunts were amassing their very significant position in silver."

Jesting Commissioners

To illustrate his point about the commission's inactivity, the New York Democrat played a tape recording of a closed commission meeting last July 27 at which the Hunts were discussed; on the tape, the commissioners are heard laughing and jesting about the Hunt trading. A committee aide said the brief excerpt exemplifies the "lack of depth" in some of the commission's closed meetings concerning market activity.

On the tape, a voice asks whether the Hunts "are just having fun, just horsing around, like playing monopoly like you and I might do, or sooner and done prior." The subcommittee identified the voice as that of David Gartner, one of the commissioners. Laughter followed on the recording. Then a commission aide said the Hunts' net holdings in silver futures at that time totaled $675 million. "That's a lot of money," said Mr. Gartner. Commissioner Read Dunn then interjected: "For you maybe." Again, laughter followed.

In defense of the attitude reflected in the recorded comments, Mr. Stone noted that the commission meeting in question occurred when silver's price had just begun to edge up. Nobody could have foreseen how much higher it would go, or how serious the problem would become, he said.

Mr. Gartner, after the hearing, claimed that his comments on the tape recording had been taken "out of context." He said, "That was one small part of a meeting that lasted more than an hour. The committee is obviously trying to put the CFTC in a bad light." He added that the excerpt disclosed some "highly sensitive market data"—the Hunts' holdings—and should have been kept secret. Last winter, Mr. Gartner had unsuccessfully sued the committee to prevent it from obtaining the tape recordings.

Although the CFTC didn't act to restrain the Hunts at that February meeting, it did subsequently urge the silver exchange to raise margin requirements, or the cash down payment required to trade in silver. Mr. Stone said, that as much as he might have liked to, he hadn't the legal authority to make the exchanges raise margins. That's debatable, however, as the commission has emergency powers to raise margins. After the hearing, Mr. Stone explained that he didn't believe there had been enough of an "emergency" to warrant such action.

Mr. Stone acknowledged, however, that "we aren't in a position to say we used every tool" at the CFTC's command to re-

WSJ April 1, '80

Hunt Silver Dealings Cause Woes for Bache, Engelhard Minerals

Continued From Page Three

strain the Hunts and other big speculators. For instance, he said the commission could have imposed limits on how much silver any one trader can hold; as with the margins, the commission merely "jawboned" the exchanges to set limits, which they ultimately did, said Mr. Stone. After the hearing, he said it would have been "too cumbersome" and have taken too long under current laws for the commission to have ordered limits. He would favor legislation to strengthen the commission's hand on setting limits, the CFTC chairman said.

The SEC also is exploring possible "remedies" for the shortcomings in its oversight of brokerage firms that handle transactions in both commodity futures and securities. Chairman Williams told the subcommittee such steps include clearer separation by such firms of the two types of trading, stricter limits on customer speculation, and increased capital requirements for brokerage firms with exposure to possible commodities trading losses.

The disclosure of the huge debt at the Bache securities unit conflicts with a Bache Group statement Friday that Bache Halsey Stuart Shields had liquidated the Hunt accounts without loss to itself.

Harry Jacobs Jr., Bache Group chairman and chief executive officer, said in an interview yesterday that the difference represented "bookkeeping information dealing with commodities margins that came to light over the weekend. We wouldn't tell you, the stock exchange and the SEC one thing on Friday and another thing on Monday."

Still unanswered is whether the debts in the two metals units were actually incurred there or were switched to them from Bache Halsey Stuart Shields to ease a potential capital squeeze at the securities subsidiary.

Mr. Jacobs declined to comment on this point, saying that it would "be improper" to discuss any movement within the account of any customer.

Despite Bache's denial that the Hunts received "preferential treatment," Wall Street sources outside the concern yesterday circulated reports that the Bache Group board, in a special measure in early March, authorized Bache Halsey Stuart Shields to increase by $70 million its credit line to the Hunts. This would represent an estimated doubling of the brothers' credit line at the unit.

Mr. Jacobs declined to comment specifically on the report of the meeting. However, he said that "in general, big customers get big margins and small customers get small margins." He added that the Hunts didn't get any favors when it came time for Bache Halsey Stuart Shields to liquidate their holdings.

For Bache, the harrowing events of the past few days may have more than financial or regulatory repercussions. Insiders at the company say they expect a shake-up that could reach from the Bache Halsey Stuart Shields commodities department all the way to Bache Group top executives.

Mr. Jacobs said management changes haven't been discussed by the Bache Group board or executive committee. However, he added: "The board would want to look into tightening up procedures after such a big credit problem." He said he would know in a couple of weeks what the new procedures would be.

Commodities

April 1, 1980

Chaos Following Hunts' Losses in Silver May Have Killed Off Speculation Boom

A WALL STREET JOURNAL *News Roundup*

The chaos sparked last week by the Hunt family's silver losses may have provided the final blow to the recent commodities boom, specialists say.

Commodity speculation, already dampened by high interest rates and fear of a recession, is expected to decline even more in the wake of the turmoil set off by plunging silver prices last week, analysts say. "People are so frightened by the events of the past few days that anyone who doesn't have to trade just isn't trading," said one broker.

Futures Markets

Silver prices recovered yesterday to settle at $14.20 an ounce, $2.20 above Friday's closing quote and $3.40 higher than Thursday's close of $10.80 on the New York Commodity Exchange. Most other commodity prices, however, fell or remained little changed.

Following the Hunts' multimillion-dollar losses, traders predict other big speculators are likely to stay on the sidelines for a while. The Hunt losses "showed you can't control a market, regardless of how big you are," says Harold Sacks, manager of Harold Sacks & Co., a New York commodities concern. "That's got to make speculators nervous about taking big positions for a while."

Commodity prices and trading volume have been in a steady decline anyway for the past two months, as high interest rates have made it increasingly expensive to finance inventories, analysts observe. "The Hunt matter just speeded us along," says Thomas Mann, an economist for Thomson McKinnon Securities Inc.

The number of contracts outstanding, a key measure of futures market activity, has dropped sharply in the past two months, particularly in the commodities that had attracted the most speculative activity. In gold, copper, silver and sugar, the total number of contracts outstanding has dropped by 34% to 313,000 since late January.

Price declines in the past two months have also been severe. Silver has dropped 75% to $14.20; copper has fallen 61% to 86.5 cents a pound; gold has fallen 44% to $501.50, and soybeans have declined 8% to $5.83 a bushel.

Thus, although few would deny the roiling effect of the Hunt's recent troubles on commodities markets, many traders agree that sluggish trading is "a result of the economic situation," says Jack Boyd, a commodities specialist for Drexel Burnham Lambert Inc. "Even if the Hunts' problem was settled this minute, the markets still would have to contend with higher interest rates."

Tuesday, April 1, 1980 The Washington Post BUSINESS & FINANCE

Hunts Sacrifice a Fortune in Oil Wells, Silver

Photos by James K. W. Atherton—The Washington Post

CFTC's James M. Stone, left, and SEC's Harold M. Williams, at hearing.

Texans Swap Property to Pay Debts

By Jerry Knight
and James L. Rowe Jr.
Washington Post Staff Writers

Huge new losses on silver speculation yesterday forced the Hunt brothers of Texas to give away [illegible] million worth of their oil wells and [illegible] tons of silver to settle their debts.

Like a Monopoly player who lands on Boardwalk with a hotel and can't pay the rent, the Hunts swapped their other property to meet their obligations to Engelhard Minerals & Chemicals, a big silver dealer.

Nelson Bunker Hunt and his brother Herbert apparently lost close to [illegible] million when they signed a deal to buy 19 million ounces of silver from Engelhard for $35 an ounce and the price plunged to $14.

The Hunts also owe their silver broker, The Bache Group, another [illegible] million in previously undisclosed losses on silver trading, Bache officials revealed yesterday.

Bache had announced last Friday that it had sold out all the Hunts' silver investments without any loss. But after checking its books during the weekend, Bache said it turned up an additional $10 million in losses by its Bache Halsey Stuart Shields Inc. brokerage in New York and another [illegible] million at two Bache subsidiaries in London.

Bache's heavy dealings with the Hunts—who own about 5.6 percent of Bache's stock—are being investigated by the Securities and Exchange Commission, the Commodity Futures Trading Commission and a congressional subcommittee, it was learned yesterday.

SEC Chairman Harold Williams and CFTC Chief James Stone testified yesterday before the subcommittee, headed by Rep. Benjamin Rosenthal (D-N.Y.)

Rosenthal questioned both regulators about the propriety of a stock broker doing so much business with one customer that the customer's financial problems could force the broker to the brink of bankruptcy.

Stone said his agency is looking into the question and is concerned about possible conflicts of interest when "a very large customer of a firm is also a large shareholder of that firm."

Williams, however, asked to defer answering the question, in effect admitting the SEC is investigating Bache's dealings with the Hunts. The SEC reportedly is studying whether Bache's business with the Hunts should have been disclosed to other stockholders.

A Bache official in New York denied any favoritism was shown the Hunts, saying they "never asked for any preferential treatment and they were never given any."

Bache disclosed, however, that part of the collateral the Hunts put up to finance loans for silver speculation included 880,000 shares of Bache stock, worth $44.5 million last week.

Trading in Bache shares was halted by the SEC after the Hunt's financial problems became public last Thursday. At one point, the Hunts owed Bache more than $100 million, almost two-thirds of the company's net worth.

When the Hunt's were unable to come up with the $100 million, Bache began raising money to pay the debt by selling both the Hunts' silver bullion and their silver futures contracts.

After Bache announced Friday that it had sold off the Hunts' collateral and settled their debts, it appeared the silver crisis might be over.

Since then the additional [illegible] million debt to Bache and the half-billion deal with Engelhard have been disclosed.

The Hunts also are reported to be losing about $1 million a day on at

See SILVER, D6, Col. 1

Rep. Benjamin Rosenthal asks questions.

Hunts Sacrifice a Fortune To Pay Off Silver Debts

SILVER, From D1

least 2,000 silver futures contracts they still own, as the value of those contracts continues to slide.

Cash silver prices plunged from a $50 peak in January to $10.80 last Thursday. Silver rebounded to $12 on Friday and climbed again yesterday to $14.20 on the New York Commodity Exchange.

Contracts for delivery later this year are still trading for around $20, however, because exchange rules permit the price to decline only $1 an ounce a day.

Those losses are small, however, compared with the loss both the Hunts appeared to have taken on the Englehard deal.

Back in January, when prices were still climbing, the Hunts signed a contract to buy 19 million ounces of silver from Englehard for $35 an ounce, a total of $665 million.

The Hunts were supposed to start picking up their silver—and paying for it—yesterday. Rather than pay $21 an ounce more than the current price of the metal, the Hunts asked to negotiate a settlement. Later in the day, Englehard said the Hunts had been released from their obligation.

Instead of getting 19 million ounces of silver from Englehard, the Hunts agreed to give the company 8.5 million ounces—more than 265 tons—worth $119 million at $14 an ounce.

The Hunts also agreed to give Englehard their interest in several Canadian gas and oil properties in the Beaufort Sea. Englehard said the oil properties are worth $400 million.

On paper, at least, the deal was a massive windfall for Engelhard. Instead of selling 19 million ounces of silver for $665 million, Englehard got to keep its silver, got another 8.5 million ounces from the Hunts, and collected the Hunts' Beaufort Sea holdings as well.

The Hunts are expected to be questioned about their multimillion-dollar silver dealings when Rosenthal's committee holds additional hearings on April 14 and 15.

Committee sources said Rosenthal is planning to invite the Hunts to testify and is planning to subpoena records of the commodity commission in an attempt to learn just how much silver the Hunts own.

CFTC Chairman James Stone testified yesterday that Nelson Bunker Hunt has been buying silver since at least 1973, but apparently has never violated any existing laws in building a massive hoard.

Rosenthal made public a tape recording of a closed CFTC meeting last July in which CFTC staff members said Hunt's holdings then amounted to 10,000 futures contracts, each for 5,000 ounces of metal.

At July's $9.50 an ounce price, the Hunts' holdings were worth $475 million. If they still owned those contracts in January, when the price hit $50 an ounce, they were worth $2.5 billion.

APRIL 11, 1980 (WSJ)

Commodities

Silver-Futures Traders and Regulators Debate Use of Controls to Forestall Chaos

By JULIE SALAMON

Staff Reporter of THE WALL STREET JOURNAL

[illegible]

Price Surge

[illegible]

Focus on Margins

[illegible]

S.E.C. Offers Silver Assurance

By JUDITH MILLER

Special to The New York Times

WASHINGTON, April 14 — Harold M. Williams, the chairman of the Securities and Exchange Commission, said today that the agency had "reasonable assurance" that no brokerage firm or publicly traded company was in jeopardy or "financial difficulty" because of last month's silver panic.

Mr. Williams made his remarks in testimony before a House subcommittee that has been investigating the causes and implications of the sudden collapse of the silver market.

In response to questioning from Representative Benjamin S. Rosenthal, the Queens Democrat who heads the subcommittee, Mr. Williams said that he was "concerned" by the doubling in contingent liabilities of Bache, Halsey, Stuart, Shields Inc., the brokerage firm partly owned by the Hunt family.

Liability Rise to Be Studied

Mr. Williams pledged to investigate why Bache's contingent liabilities, listed as bank letters in lieu of margin deposits, jumped in the firm's Jan. 31 report to $260 million from $90 million at the end of October 1979.

Mr. Rosenthal also expressed concern about Bache's practice of using silver offered as collateral by the Hunts to borrow from banks to support further speculation. Mr. Williams agreed that, as Mr. Rosenthal put it, the loan practices "built an upside-down pyramid" that ultimately collapsed around silver traders when the price began to plummet.

"We do not anticipate that the securities markets will likely experience any more severe aftershocks caused directly by the recent upheaval of the silver markets," Mr. Williams told the panel.

Mr. Williams added, however, that the long-term impact of the silver panic on financial markets was more difficult to assess, and he endorsed a series of changes in the regulatory structure of commodity futures trading to prevent similar episodes in the future.

Specifically, he endorsed authorizing the Federal Reserve Board to impose margin requirements on futures trading, that is, require investors to place a certain level of money down on commodity futures contracts as they ar-

Associated Press

Harold M. Williams, right, chairman of the Securities and Exchange Commission, conferring with Representative Benjamin S. Rosenthal prior to testifying before a House panel yesterday on the collapse of the silver market.

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NY TIMES April 15, 1980

Silver Assurance By S.E.C.

Continued From Page D1

are now required to do for trading in equity stock.

He also urged that the Commodity Futures Trading Commission be granted authority to require exchanges to adopt strong "suitability requirements" for investors in the futures market.

Meanwhile, the subcommittee continued its discussions with Nelson Bunker Hunt and W. Herbert Hunt over their voluntary appearance before the panel. The subcommittee can vote to subpoena the Hunts if they refuse to appear, but the issue of the Hunts' testimony is expected to be considered tomorrow when members of the commodity trading commission appear before the panel.

In testimony prepared for the hearing tomorrow, one commissioner, David G. Gartner, will state that the agency has "nothing to apologize for" and that the silver episode was "free enterprise at its finest." The commission has been criticized in the subcommittee's hearings for failing to take tougher measures sooner to prevent the silver panic.

Hunts Set To Testify On Silver

By Jerry Knight
Washington Post Staff Writer

Nelson Bunker Hunt and W. Herbert Hunt are scheduled to testify before two congressional committees today to add their version of what happened in the silver market to the picture that has emerged from three days of hearings this week.

Late yesterday attorneys for the Hunts said the billionaire brothers will answer a subpoena from a House government operations subcommittee that has threatened the Hunts with jail if they don't appear.

The brothers agreed to meet with the House panel, chaired by Rep. Benjamin Rosenthal (D-N.Y.) in the morning, before their afternoon appearance at a Senate subcommittee headed by Sen. Donald Stewart (D-Ala.).

The brothers failed to show up at Rosenthal's hearing on Tuesday and the subcommittee voted to cite them for contempt of Congress, a charge that could lead to a jail term.

Yesterday Stewart's Senate subcommittee made public a Commodity Futures Trading Commission report that gives the most detailed explanation yet of the Hunts' silver-speculating spree. Stewart's hearings produced these disclosures:

- A group of banks and metal dealers were preparing last month to step into the silver market and buy more

See SILVER, A8, Col. 1

than $1 billion worth of metal to keep prices from falling further. The bailout effort was called off after silver prices bottomed out at $10.80 on March 27 and began to go up again.

- Two major banks loaned $233 million to a subsidiary of Bache Group Inc. and took 17 million ounces of silver as collateral. The banks sold 10 million ounces of the silver on March 28 and paid off $133 million of the debt.

- Two large privately owned commodity firms, ACLI International and ContiCommodity Services, suffered such heavy silver trading losses that their owners were forced to come up with $130 million in new capital to keep them solvent. ACLI is controlled by Adrian C. Israel, chairman of People's Drug Stores of Washington.

- Foreign traders, dealing through ACLI, Conti and a Swiss bank, followed the Hunts down the silver path and bought tons of the metal, contributing to the crisis in the silver market.

Stewart queried Federal Reserve Board Chairman Paul A. Volcker and several other witnesses yesterday but failed to get an answer to the most basic question raised in the three days of hearings:

Why are the Hunts arranging a $1 billion loan from a group of banks when most of their known silver-speculating debts already have been paid?

The loan has become one of the central issues in the hearings, because it is being negotiated with the knowledge and consent of Volcker, who has asked banks not to make loans for speculative purposes.

Volcker testified yesterday that special provisions of the loan agreement will require the Hunts to dispose of much of their silver hoard "in an orderly fashion."

Calling it "a damage control loan," Volcker said the huge borrowing will let the Hunts pay off debts to brokerage houses. CFTC officials, however, said the Hunts' futures-speculating debts never exceeded $120 million and virtually all of that amount has been paid.

Stewart and other committee members repeatedly criticized the billion dollar bailout, pointing out that farmers, homebuilders and small businesses are in financial trouble because they cannot get loans.

Sen. John Melcher (D-Mont.) asked Volcker and other witnesses whether the Hunts and their fellow silver speculators violated federal antitrust laws by artificially inflating silver prices.

Volcker and Treasury Department officials said they had not raised the issue. CFTC Chairman James Stone, on the advice of his agency's chief counsel, refused to say whether commodity regulators have talked with the Justice Department about possible antitrust violations. Melcher said he took that to mean the answer was yes.

Plans by a group of investment bankers and metals dealers to step into the market were revealed by Dr. Henry Jarecki, chairman of Mocatta Metals Corp., the New York affiliate of a London firm that is one of the world's biggest gold and silver dealers.

In prepared testimony, Jarecki said the group members "were prepared to prevent any serious economic dislocations from occurring" from the collapse of silver prices.

"We had notified the exchanges . . . and the brokerage houses involved that if a massive selling wave hit, we would need to know only the exact number of ounces that had to be taken up to prevent further panic selling," he said.

The Jarecki group was prepared to pour more than $1 billion into the silver market, in hopes not only of preventing prices from falling further, but also of making quick profits of hundreds of millions when prices rebounded. The plan was called off after silver climbed from $10.80 on March 27 to $13 the next day.

The CFTC report showed that daily losses "in excess of $50 million had become commonplace" for the Hunts, when silver prices were falling.

According to the CFTC, the Hunts at the end of December owned 59.2 million ounces of silver — worth more than $2 billion at that time — and another 38.6 million ounces were in the hands of foreign traders dealing with ContiCommodities.

The Hunts and the foreign group also held more than 17,700 silver futures contracts, allowing them to buy another 88 million ounces.

Stone said the CFTC is taking legal action against the Swiss bank through which many foreign investors speculated in silver because the bank has refused to name its clients.

Washington Post
5-2-80

The Washington Post BUSINESS & FINANCE

Saturday, May 3, 1980

Peeking Inside A Silver Spree

By Jerry Knight
Washington Post Staff Writer

Nelson Bunker Hunt and his brother, W. Herbert, told congressional committees yesterday they are three-quarters of a billion dollars in debt as a result of their silver speculating spree, but they don't know yet whether they made or lost money on the deal.

The Hunts testified they may be able to minimize their losses with the help of a $1 billion bailout loan from a group of banks, arranged with the blessing of Federal Reserve Board Chairman Paul A. Volcker.

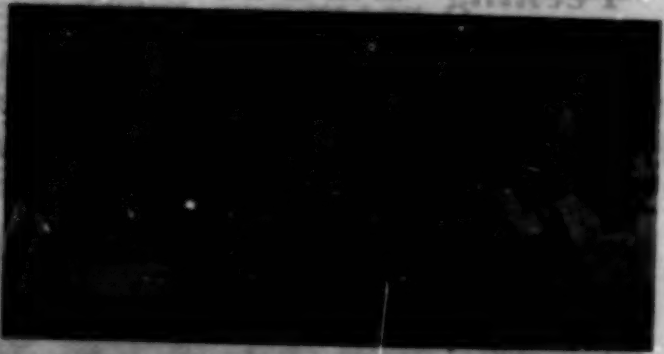
The loan will let the brothers keep their millions of ounces of silver, rather than force them to sell it now. Selling the silver immediately could drive down prices, causing heavy losses for both the Hunts and the banks and brokers to whom they owe money.

Nelson Bunker Hunt testified he has silver speculation debts of about $[illegible] million and W. Herbert said his obligations come to about $400 million.

Bunker and Herbert's debts are so great that they are getting financial help from their brother Lamar, owner of the Kansas City Chiefs professional football team.

Lamar is a partner with Bunker, Herbert and the Hunt family-owned Placid Oil Company in a new partnership formed to pay off the silver speculation debts. Lamar has no silver debts of his own. "He's helping out his brothers," said family lawyer Ivan Irwin of Dallas in an interview.

Attorney Ivan Irwin (left) confers with Nelson Bunker Hunt yesterday. Between them is brother W. Herbert Hunt.



Crain's Chicago Business, May 19, 1980

Futures exchanges hire lobbyist to deflate silver-scandal reforms

By PAUL [illegible]

WASHINGTON—The nation's futures exchanges, faced with congressional moves for more regulation in the wake of the gyrations in the silver markets last March, are preparing for an uphill legislative battle [illegible].

Legislation introduced last week by Sen. William Proxmire (D-Wis.) that would give the Federal Reserve power to set margins on futures contracts has been referred to the Senate Banking Committee, which he chairs.

That was viewed as a worrisome [illegible] by industry observers who had hoped the Proxmire bill would at least be jointly referred to the Senate Agriculture Committee, a friendlier forum where legislation affecting commodity futures is normally considered.

To mend the gaps in their contacts with members of the banking panel, the nation's three largest futures markets—Chicago Board of Trade, Chicago Mercantile Exchange and New York's Commodity Exchange—have retained a high-powered Washington lobbying firm with close ties to that committee.

The exchanges hired Charls Walker Associates, headed by a former deputy secretary of the Treasury under John Connally. The firm was largely responsible last year for passage of the capital gains tax cut. Handling the effort for the firm will be [illegible], a former [illegible] of the [illegible] and First National Bank of Chicago [illegible], according to Clayton Yeutter, president of the Chicago Mercantile Exchange.

Although the exchanges already have their own lobbyists in Washington, the Walker firm was needed because they "haven't worked all that much with the banking committees," Mr. Yeutter said. "There was no reason to develop a working relationship."

The Proxmire bill is only one of several legislative efforts that have appeared or are expected in the congressional reaction to the [illegible] in the silver market. Several days of hearings have already taken place before Senate and House committees and more are scheduled later this month, including two days before the Senate Banking Committee on May [illegible].

A bill introduced by Rep. Dan Glickman (D-Kan.) would give the Commodity Futures Trading Commission (CFTC) standby authority to set margins, a power that the agency has now only if it declares an emergency in a market.

Rep. Benjamin Rosenthal (D-N.Y.), who chairs a Government Operations oversight subcommittee, is planning to introduce a bill that would spread regulatory authority over the futures business to the Federal Reserve, the Securities and Exchange Commission and the Treasury Department, according to an aide.

The Rosenthal bill would set up an interagency council of the four agencies, making a formality of what has recently become a voluntary effort by the agencies to share information.

But there is a possibility that veto power over CFTC decisions might be given to the council. "New contracts might have to be approved by the interagency council," said [illegible], Rep. Rosenthal's aide. If it became

Continued on Page [illegible]

Exchanges hire lobbyist . . .

Continued from Page 3

law, that kind of authority would probably cut back the proliferation of futures contracts based on various financial instruments, many of which have been opposed by the SEC and Treasury.

Despite all the activity, prospects for enactment of any legislation are extremely uncertain. However, it is clear that the exchanges are concentrating on the upcoming committee hearings because it is feared that once a bill gets past committee it stands a good chance of passage.

If the issue is presented as a choice between the integrity of the U.S. financial system and possible overregulation of the futures industry, "I'm fearful of the consequences," said Rep. Thomas Foley (D-Wash.), chairman of the House Agriculture Committee and a strong ally of the futures exchanges. "Many may feel the better risk is to take overregulation."

However, industry officials appear confident that they can make the members understand their case in the upcoming hearings. "Our strategy is strictly education," said [illegible], chairman of the Futures Industry Association. Giving [illegible] government control over futures margins "sounds like it's in the public interest but it's not."

WSJ May 20, 1980

35 CENTS

Regulatory Row

Futures-Trading Panel Incurs Much Criticism In Wake of Silver Flap

Agency Is Accused of Failing To Curb Hunt Brothers; Some Defend the Market

Commission Torn by Discord

By [illegible]

[illegible]

Quick Action Unlikely

[illegible]

Evidence Lacking

[illegible]

Source of Discord

[illegible]

Please Turn to Page 41, Column 1

Continued From First Page

[illegible]

Regulatory Row: Futures Agency Gets Much Criticism in Silver Flap

and reorganizing the bureaucracy. Still, the agency "has a long way to go," one congressional aide says.

The commission is no stranger to controversy. In 1976, the CFTC had to sort out the largest contract default (on Maine potatoes) in a century of U.S. futures trading. Two years later, it was accused of sleeping on the job while commodity-options con artists fleeced naive investors. Last year, the CFTC lost a much-publicized "test case" against foreigners who resist commission investigations because in court papers it had erroneously cited Wiscope Ltd., which is no affiliate of the trading company it wanted, Wiscope S.A. of Switzerland.

In the silver case, a tape-recorded excerpt of a closed commission meeting last summer, released recently by Rep. Rosenthal, revealed the commissioners joking and jesting over the Hunt brothers' silver transactions. CFTC officials, however, say the excerpt doesn't reflect the tone of the whole meeting, and they note that it was recorded before silver prices skyrocketed.

Here's what the agency did about the silver situation, according to its officials:

As early as last July, the commissioners, in their weekly closed market meetings, began watching silver trading uneasily. By fall, when prices nearly doubled from $9 an ounce, staffers were occasionally auditing brokerage firms. They also began gathering information on the dealings of the Hunt family and other big speculators whose buying was fueling the market.

Exchanges' Actions

In October, the commissioners met publicly to discuss the problem. But they didn't act, partly because one exchange that trades silver, the Chicago Board of Trade, had recently set limits on how many silver contracts a speculator could hold. The other market, the Commodity Exchange Inc. in New York, had tightened credit by raising margins—the money that traders must put up to trade futures.

After a brief pause, prices continued rising. Commission officials began "jawboning" New York officials to set trading, or "position," limits like those in Chicago—but without result. Finally, on the eve of a Jan. 8 private meeting between industry leaders and the commissioners, the New York exchange voluntarily set such limits. Two weeks later, prices peaked at $50.35 an ounce and began a long decline, ending on March 27 and 28 with a deafening crash.

Silver prices bottomed out at $10.80 an ounce. The stock market staggered briefly because of rumors that major brokerage firms were near financial ruin.

Few people criticize the commission's action during the crash itself. But some Federal Reserve and SEC officials say the CFTC should have reined in the big speculators long before the crash and thereby prevented it. Specifically, they say it should have ordered position limits, rather than waiting for exchanges to set their own. It currently sets limits on agricultural futures trading.

But such speculator restraints are controversial. Mr. Stone advocates them for "all commodities at all times." Other commission officials call them hard to enforce and unfair to big speculators: "The Hunts are just like everyone else, except they're big," one commission staffer says. Therefore, the government shouldn't bar big traders unless they use their size illegally to manipulate markets, he says.

Continuing Dispute

In the agency's October 1979 meeting, the commissioners considered studying the idea. But they couldn't agree whether to look into ordering the limits or merely recommending them to exchanges. So they did nothing. And the same dispute stymied the commission at a meeting May 13; that time, though, the commissioners rejected a Stone proposal to study government-imposed limits but agreed to study a proposal that the industry regularly consider setting its own curbs.

Another criticism is that the agency wasn't tough enough with the exchanges. When the commissioners told a House subcommittee last month that their strongest act had been to privately urge exchange officials to restrict speculation, the committee's chairman, Rep. Rosenthal, asked in exasperation: "Are you a regulator or a persuader?"

In response, commission officials say that to act officially and forcefully, they needed proof that someone was manipulating silver futures prices or that futures prices didn't accurately reflect the underlying supply and demand for silver. Mr. Gartner says that "we were advised by our staff week after week" that there wasn't any such evidence.

Staffers still defend their assessment. But they say the paucity of data on foreign silver dealings, and the difficulty of verifying trading reports, made their task difficult.

Whatever caused the collapse, government officials are thinking of ways to prevent a recurrence. The CFTC is again studying position limits, and the SEC is investigating the possible conflict of interest that arose when the Hunts bought stock in one of the brokerage firms, Bache Group Inc., handling their silver business. Both agencies might tighten their accounting rules to make sure brokerage firms keep their books in order.

In Congress, the five committees that are squabbling over jurisdiction in the publicity-catching case are discussing several legislative remedies. The most serious proposal so far would grant the Federal Reserve margin-setting authority for futures—a power currently held by the industry. Its proponents say that by controlling margins and credit, the government can curb speculators. Its foes say it would drive small traders from the market and give billionaires such as the Hunts an even-stronger hand on prices. But with Congress distracted by elections and industry lobbyists already mobilizing against change, little action is expected this year.

In the meantime, the White House hopes to resolve the CFTC's internal squabbling by choosing someone to fill the commission's long-vacant fifth seat. The President's staff is close to nominating a candidate for congressional approval, a White House aide says. But at least one CFTC aide isn't holding his breath waiting for the appointment. He expects the President will "have a hard time finding someone to fit in with this bunch."

DAILY NEWSPAPER — AIR DISPATCH

American Metal Market

Brass Mill Production Section in Today's Issue

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THE POLITICS OF SILVER

Hunt Puzzle Starts to Fall Into Place

By MARTYN CHASE

NEW YORK — Like an incredibly complex mosaic, the pieces of the Nelson Bunker Hunt silver puzzle are starting to fall into place.

An investigation by the American Metal Market over the past three months shows that the impact of the silver fiasco was far wider than generally thought

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First in a series

by either the general public or by many metals industry insiders.

The price effect has been well documented: silver prices tripled in 1979 from the $6 per troy-ounce level to $18, then soared to $48 on Jan. 17 before plunging to a low of $10.80 on March 27 when the Hunts ran into difficulty meeting margin calls.

But the fallout from this roller-coaster price ride is far from over with possible repercussions still ahead on both the regulatory and political front in Washington and possibly in the market as well.

In sifting through congressional testimony, and staff reports at the Commodity Futures Trading Commission and in interviews with government officials and metals executives, a number of patterns and threads to the silver story are starting to emerge.

NELSON BUNKER HUNT — The impact of his silver market manipulations may be wider than initially suspected.

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Hunt Puzzle Starts to Fall Into Place

(Continued from first page)

- The Hunt interests appear to have circumstantial ties to previously unidentified silver accounts traded on the floor of the Commodity Exchange by ContiCommodity Services Inc. and Acli International Commodity Service Inc. The connections are through a major Swiss bank, Banque Populaire Suisse, which was represented on the Comex by both Acli and Conti, and through key New York silver traders and also through Arab and Brazilian investors.

- A top Commodity Futures Trading Commission official told AMM that both Conti and Acli suffered heavy losses in the silver debacle in the immediate aftermath of the March silver price plunge and that both trading firms needed substantial bailouts from their parent companies to remain viable. According to testimony by Walter Goldschmidt, Conti chairman, his firm lost $10 million on silver trading by one client alone — Naji Nahas, who based at least some of his business operations in Geneva.

- Several congressmen, including some with key committee assignments in the commodities area, are heavy commodity traders for their own accounts. In one case, Rep. Steve Symms (R., Idaho) made significant silver investments two weeks before cosponsoring legislation to buy $500 million worth of silver for the national stockpile. He sold his silver futures two weeks after the stockpile bill was introduced last year and made a substantial profit on the transaction.

- A few large banks played a significant part in the silver fiasco by continuing to grant loans to the Hunts — and others — for speculative purposes last fall, despite the fact that Federal Reserve Board Chairman Paul Volcker had specifically called for an end to such speculative loans. A major Chicago bank was involved in helping the Hunts send large amounts of silver to Europe.

- An attempt to avoid income taxes through straddle trades may have been a factor in the silver gyrations. Although federal authorities disagree on the importance of this aspect, the Internal Revenue Service has begun an extensive investigation into straddle trading.

- Legislative proposals to sell off silver from the General Services Administration stockpile were successfully derailed last year by congressmen and senators who later turned out to have received significant campaign contributions from Hunt family members. At the same time, some of these legislators were backing a bill introduced by Rep. Larry McDonald (D., Ga.) to buy silver for the stockpile.

- The Hunts were not only bullish on silver, but also bullish on gold. A lengthy list of South African gold mining stocks, worth more than $100 million, were among the assets turned over by the Hunts to the Placid Oil Trust which was formed to help the Texas oil billionaires restructure the debt which they incurred following the silver price plunge in March.

- At presstime yesterday, the Justice Department said it was studying the transcripts of congressional testimony given in recent weeks by Nelson Bunker Hunt and his brother, W. Herbert Hunt as well as testimony from William Bledsoe, a former Hunt aide, for possible perjury. Herbert Hunt testified that he and his brother operated independently in dealing in the silver market, but Bledsoe had said under oath that they operated in concert.

- A federal task force, involving officials from the Treasury Department, the CFTC, the Securities and Exchange Commission, the IRS and other agencies, is actively investigating the Hunt affair with a full report due by October.

(Tomorrow: The Hunts, Conti and Acli)

DAILY NEWSPAPER — AIR DISPATCH

American Metal Market

VOL. 88, NO. 133 THURSDAY, JULY 10, 1980 $1.25

THE POLITICS OF SILVER

Congress Probe Eyes Foreign Investors' Role

By MARK HOSENBALL

WASHINGTON (FNS) — The role of foreign investors in volatile silver price movements and later in massive brokerage house losses remains a major mystery in the Great Silver Saga, but this is an area continuing to attract Congressional and regulatory attention.

Sen. Donald Stewart (D., Ala.), whose Senate Agriculture subcommittee has done some of the most thorough Congressional examinations of silver market events, tried to resolve some of the mysteries at a recent hearing. But some of Stewart's aides admit the hearing may have raised as many questions as it answered.

The star witnesses were Walter Goldschmidt and Norton Waltuch, respectively chairman and vice-president/silver trading of ContiCommodity Services Inc., the brokerage arm of Continental Grain.

The hearing early established the almost legendary proportions of Waltuch's reputation as a silver trader: both Goldschmidt and Waltuch acknowledged that Lee H. Berendt, president of the Commodity Exchange, ordered Conti last fall to keep Waltuch out of the silver pit at Comex. "It has often been said that when Norton walks on the trading floor the price goes up," Goldschmidt acknowledged. But he added that Conti regarded the Comex request as "improper."

The Commodity Futures Trading Commission, in a report on silver market events submitted to Congress last spring, explained at least part of the reason behind the Waltuch mystique: Waltuch handled several blockbuster foreign silver accounts.

Among those accounts traded through Waltuch were a supposed "hedging" account maintained by Banque Populaire Suisse, Switzerland's fourth largest bank, and the account of Naji Nahas, a Geneva-based businessman known to be at least friendly with the best known American silver bulls, the Hunt family.

At the end of August 1979, the CFTC reported, Waltuch's foreign accounts held 6,300 long positions in the Commodity Exchange December 1979 silver future, or 25 percent of the open interest in that contract. The largest positions within that aggregation were maintained by Nahas and Banque Populaire, the CFTC said.

Later, after analyzing the trading behavior of foreign accounts at ContiCommodity and Acli International (where Banque Populaire had maintained another account), the CFTC concluded that a group of accounts which included those of Banque Populaire, Nahas, and Waltuch's personal account "appeared related since similar trading patterns and, in some instances, common ownership or control were discovered." The CFTC cautioned, however, that "no relationship" has been established between the Waltuch accounts and any accounts owned or influenced by the Hunt family.

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The CFTC's findings — and its decision in May to take administrative action against Banque Populaire for failing to respond to CFTC demands for the identity of the beneficiaries of its silver trading account — fueled already rampant speculation about a connection between the Hunt family and mysterious foreign investors.

Was Banque Populaire a cover for wealthy Arabs, perhaps Saudis, such as the ones allegedly introduced to the Hunts by former Texas Gov. John Connally? Was Banque Populaire perhaps a cover for the Hunts themselves?

(Continued on page 4)

Silver Probe Eyeing Foreign Investors' Role

(Continued from first page)

Waltuch and Goldschmidt told Stewart they couldn't answer questions about who benefited from the Banque Populaire account. The Conti executives said they were not told who, if anyone, the bank was trading for, and said they didn't ask the Swiss banks for such information.

Moreover, Waltuch insisted he had no discretion to make trades for the Banque Populaire and Nahas accounts, who, he said, made their own investment decisions. As the Banque's and Nahas' broker, he did give the clients advice "daily...sometimes more than once." That advice, he acknowledged, was bullish beginning in autumn 1978.

Waltuch said he traded his personal account and "made money" in silver until liquidating all his personal positions in late 1979 and early 1980.

Waltuch also acknowledged that he met Nelson Bunker Hunt at least three times last year. At the first meeting, a 10-minute talk at the yearling (horse) sales in Kentucky, Hunt asked Waltuch what the broker thought about silver. Waltuch said he told Hunt he was "very bullish."

Hunt and Waltuch met again in September and October 1979, as silver was starting its price climb, Waltuch told the Congressional subcommittee. These meetings were in Paris and Zurich and Nahas and a couple of Nahas' acquaintances also were present on at least one occasion. Waltuch acknowledged Hunt was "picking my brain" about silver. Waltuch said he told Hunt he still was bullish on the metal.

Hunts Forced to Liquidate

Later, after Comex imposed silver position limits, apparently forcing the Hunts to liquidate some of their holdings, Waltuch and Hunt talked again, this time with Hunt criticizing the Comex actions, according to Waltuch. Later still, in March 1980, Goldschmidt phoned Hunt in Dallas, and eventually had breakfast with the oil tycoon, trying to sound out Hunt about possible purchases from Conti of physical silver.

But that purchase never went through nor, according to the Conti executives, did they trade silver futures or bullion for the Hunts. Senate aides caution that the Conti executives' evidence about contacts among Waltuch, Hunt and Nahas is circumstantial and provides no direct information on possible trading behavior.

In his questioning of Goldschmidt and Waltuch, Stewart produced a letter from Comex that appeared to tell the public and the traders information about their foreign clients they didn't know.

The letter, signed by Comex attorney Mark Beckstein, disclosed that as many as 17 foreign customer accounts at Conti and Acli — including the Nahas and Banque Populaire accounts at Conti — "may have assumed...silver positions...during and after January, 1980...on behalf of, or in concert with, other market participants in an attempt to circumvent the silver position rule adopted by Comex on January 7, 1980."

Made Trading Decisions

It emerged from the letter, and subsequent questioning of Goldschmidt and Waltuch, that a group of financial advisers, based in Geneva and called Advicorp, headed by Jean Jacques Bally and Pierre Alain Hirschi, two close acquaintances of Nahas, had held the power of attorney, and thus made trading decisions, for the Banque Populaire account traded through Waltuch, at Conti.

Moreover, the letter disclosed that Bally and Hirschi, the Advicorp "principals," had maintained their personal trading accounts at Acli. But Waltuch said he had known nothing about these personal accounts maintained at another brokerage house by Conti's former clients.

Waltuch also acknowledged learning perhaps too late that Nahas had offered himself as a financial guarantor for several smaller accounts traded through Conti, which were also included on the Comex' list of 17 accounts possibly trading in similar patterns.

It was also disclosed that private silver account holders with both Conti and Acli were involved in the attempt by the Hunts to issue private silver-backed bonds in Europe in March this year just before the price collapse.

Collaboration Discounted

Salim Gabriel Nassif, who held an account with Acli, and Mahmoud Fustock, who had an account at Conti, were both involved in the silver bond syndicate attempt. Nassif was described by Congressional investigators as a relative of Nahas, while Fustock's account is believed to have been guaranteed by Nahas and traded through Waltuch at Conti, possibly on instructions from Advicorp.

Congressional investigators cautioned, however, that while there may be evidence of overlapping friendships and even finance between the Hunts, Waltuch and Conti and Acli foreign account holders, this does not in any way establish that there was a deliberate pattern of coordinated trading among those interested. Investigators said that, while it's known all the traders in question were long in silver during the late 1979-early 1980 period, there is as yet no evidence of coordinated trading, particularly between the Hunts and foreign account holders.

However, Conti executives now acknowledge that had they known about some of their customers' additional interests at the time of volatile silver price swings, they might have felt less comfortable about the size of Conti's exposure through its customers.

$61-million Trading Loss

In the end, Goldschmidt and Waltuch told Stewart Nahas' Conti account alone sustained a trading loss of $61-million, later reduced to an after-tax loss of $10-million after Nahas offered ships and other assets to Conti as partial settlement.

Banque Populaire, Waltuch said at the hearings, was still slowly liquidating its silver positions.

Since late March, the CFTC reported, Continental Grain has had to inject $61-million worth of capital into its Conti Commodity subsidiary.

But despite their losses and the mysteries that remain about their clients and possible links to other silver traders, Conti executives gave no apologies for their lack of initial curiosity about some of their foreign clients.

"Senator, I don't know who the (foreign) banks were trading for," Waltuch said. If you ask too many questions you don't get the business."

(Tomorrow: Silver trading by Rep. Steve Symms of Idaho)

DAILY NEWSPAPER — AIR DISPATCH

American Metal Market

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THE POLITICS OF SILVER

Idaho's Symms Trading Futures, Linked to Hunt

By MARK HOSENBALL

WASHINGTON (FNS) — An Idaho Congressman whose district includes some of the country's largest silver mines was trading in silver futures at the time he cosponsored legislation which would have required the federal government to purchase more than $500-million worth of silver.

In addition, Rep. Steve Symms (R., Idaho) silver trading activity has become all the more controversial because of his ties with Nelson Bunker Hunt, the Texas oil billionaire whose alleged attempts to corner the silver market helped propel prices to $48 per troy ounce Jan. 17 before the bubble burst in late March.

Documents filed with the House of Representatives show Symms made two silver futures purchases, described as being worth $1,000 or less each, on May 29 and June 11, 1979, respectively. The $1,000 apparently represents the margin deposits on silver purchased, rather than the value of the entire contract, Symms aides explained.

On June 28, Congressional records show, Rep. Lawrence McDonald (D., Ga.) introduced a bill, with Symms as a cosponsor, authorizing the purchase of $513-million worth of silver for the national stockpile.

Although the silver purchase bill is still in committee, Reps. Symms and McDonald did succeed in stopping legislation to unload a substantial portion of the government's current silver stockpile.

In House subcommittee hearings on McDonald's bill later last year, government witnesses testified that it was the government's view that the nation's strategic silver stocks were adequate and that the purchases sought by McDonald were unnecessary.

During one hearing, Rep. Silvio Conte (R., Mass.) said: "I don't want to accuse anyone of wrongdoing, but it is certainly possible that these so-called reports on possible United States action to increase our silver stockpile have been instigated by persons involved in the commodity market, speculators, for their own gain."

Documents filed with Congress show Symms made three silver sales shortly after McDonald's bill was introduced. Symms' own financial disclosures to the House show he made two silver sales, each worth $1,000 or under, on July 10 and July 28, 1979, and another sale, worth between $1,001 and $2,500, on July 24, 1979.

Silver price records of the Commodity Exchange in New York indicate that on May 29, when Symms was buying, silver was trading at a high of $8.69 per troy ounce and low of $8.62. Comex records indicate that by July 10, when Symms sold, silver prices were to a high of $9.18 per ounce; on July 28, when Symms still was selling, the price was at a high of $9.88 and low of $9.36 per ounce.

Symms' financial statements to Congress indicate he had been trading in silver some time before the McDonald bill was introduced, and

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continued to trade in the metal until September 1979, when his silver trading seemed to cease.

Symms, in a written statement released by his office, contended he "I never thought about the appearance of a conflict of interest when I cosponsored the McDonald bill. But I can see how some might look at it that way.

"I certainly never had any ulterior motive in mind; my position on the stockpile issue has been consistent over the years. I do feel that we need to increase our metals stockpiles for national security reasons," he said.

While news of the introduction of a bill requiring massive governmental silver purchases usually will push prices up, Chris Ley, Symms' administrative aide, insisted his boss didn't consider this. "I

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Idaho's Symms Trading Silver Futures

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don't think he thought about that. It never occurred to him," Lay said. "McDonald came up to him on the floor and asked him to sponsor the bill. He never even thought of the bill as being a potential conflict of interest."

Although neither Lay nor Dwight Ripley, Symms' personal accountant, could say precisely whether Symms' trading at the time of the McDonald bill's introduction had earned the Congressman a profit in silver, Lay, acknowledged Symms had posted a net profit in his 1979 silver trading. He netted about $9,000 in silver, although losses in potatoes and copper meant that, overall, the Congressman's commodity account suffered a 1979 net loss of about $8,000.

Lay said that Symms, a fruit farmer before entering Congress in 1972, had been trading in futures since his entry into Congress. "Commodity trading has always been a bit of a hobby with him and to be honest he's never been very good at it," Lay added.

Symms currently is engaged in a bitter and well-publicized election campaign to unseat Sen. Frank Church (D., Idaho), liberal chairman of the Senate Foreign Relations Committee.

Symms' campaign has been a natural rallying point for right-wing financial interests represented by figures like the Hunt family.

According to Lay, Nelson Bunker Hunt and Symms have known each other since 1976, when they were introduced by Rep. Jim Collins (R., Texas) at the time the Hunt family was reportedly trying to acquire Sunshine Mining Co., which is located in Symms' district.

'Infrequent' Contacts

Hunt and Symms maintained "very infrequent" contacts, according to Lay, although Lay said Hunt in 1978 had asked Symms for advice on which candidates the Hunts ought to give campaign contributions. In 1978, Lay said, Nelson Bunker Hunt and his brother W. Herbert Hunt each gave Symms a $1,000 campaign contribution.

Last December, Lay acknowledged, Nelson Bunker Hunt also joined the campaign finance committee for Symms' race against Church, although Lay said that since joining the committee Hunt had done "nothing to raise money for Symms."

In 1978, during the course of House debate on a bill extending the life of the Commodity Futures Trading Commission, which regulates silver and other futures trading, Symms introduced an amendment that would have prohibited the CFTC from taking administrative action against anyone suspected of violating commodity trading regulations if the charges already had been filed in court.

At the time Symms introduced the amendment, the CFTC filed administrative charges against members of the Hunt family for alleged trading violations relating to their dealings in soybeans, although the CFTC earlier apparently had failed to prove its case in court.

'Not a Bailout'

Symms mentioned the Hunts when introducing the amendment on the floor of the House on July 28, 1978. He said: "And, since the CFTC did not get their way, in other words they lost their case, and there were no charges brought against the people who were accused of wrongdoing. In other words they — the Hunts — were acquitted, then the CFTC filed an administrative action. I think that this is something we do not want any regulatory agency to be doing in this government of ours."

Later in the debate, Symms was asked by Rep. Tom Harkin (D., Iowa): "Is this what is otherwise known as the 'bail-out-of-Hunt' amendment?"

Symms replied: "No, it is not the bailout. This would have no effect on the Hunt case. What has happened has already happened..."

Harkin later added: "Thank you for the clarification. This is not the 'bail-out-of-Hunt' amendment; it is the 'bail-out-of-the-Hunts-in-the-future' amendment."

Symms has lately issued a statement stating he thinks "the language of the amendment was sufficiently clear and that it applied only to post-judicial administrative proceedings on charges that had resulted in acquittal in court." Lay, his aide, said Symms hadn't discussed the amendment with the Hunts or their representatives and that the bill was drafted by Congressional staff. The amendment ultimately was defeated by a 24-6 vote.

Approved By House

During the course of the same debate, Symms also voted against an amendment intended to prevent insiders from profiting on commodity trades from information not generally available. Despite Symms' opposition, this amendment was approved by the House.

Symms recently said he had "no quarrel with the purpose" of the insider trading amendment, but he believed it was being introduced at an inappropriate time.

Lay said to his knowledge Symms never discussed silver with the Hunts, though he had "talked about his investments in silver to a wide range of people."

Lay said Symms now has stopped trading commodities himself, but maintains a small account with ContiCommodities Services Inc. New York, managed by Paul Sarnoff.

Hunts Put Up $100M in Gold Stock in Silver Bailout

By MARK ROSENBALL

WASHINGTON (FNS) — The Hunt brothers have included more than $100-million worth of gold stocks, most of them South African, in the more than $1-billion in assets they have transferred into the Placid Oil "partnership" that is supposed to restructure their silver debt, AMM has learned.

The transfer of the gold stocks is disclosed in Placid Oil documents furnished to a congressional committee, and some analysts suggested the disclosure means the Hunts may be among the largest holders of gold stocks in the world.

The documents disclose, however, that the largest portion of the assets to be put into the partnership is silver bullion and coins deemed to be worth $[illegible]. Also being transferred, the documents show, are silver forward contracts, deemed to be worth $49.2-million, and 3,000 Austrian gold coronas said to be worth $2.7-million.

The main purpose of the Placid Oil partnership is to enable the Hunts to restructure debts incurred during the collapse of the price of silver last winter. With the acquiescence, if not the tacit approval, of the Federal Reserve Board, a consortium of banks is lending Placid Oil about $1.1-billion to accomplish the bailout. The lenders expect the Hunts to liquidate much of their silver holding during the nine-year term of the loan package.

Majority Partner

The partnership documents show that Nelson Bunker Hunt will be the majority partner, holding 59 percent of the partnership, with his brother W. Herbert Hunt holding 40 percent and another brother, Lamar Hunt, holding one percent.

The partnership papers show that, between them W. Herbert and Nelson Bunker Hunt will be transferring shares in 42 gold stocks. Some of the larger gold shareholdings the Hunts are contributing to the partnership are:

Anglo American Gold Investment Co. Ltd. — Bunker Hunt contributes 7,200 shares, W. Herbert Hunt contributes 7,200 shares, deemed to be worth $1.15-million in total.

Buffelsfontein Gold Mining Co. Ltd. — Bunker Hunt contributes 178,936 shares, worth $6.26-million, Herbert Hunt contributes 11,934 shares, worth $418,000.

East Driefontein Gold Mining Co. Ltd. — Bunker Hunt contributes 210,137 shares, worth $9-million, Herbert Hunt contributes 14,738 shares, worth $[illegible].

Free State Geduld Mines — Bunker Hunt contributes 127,[illegible] shares worth $7.1-million, Herbert Hunt contributes 9,647 shares, worth $[illegible].

Harmony Gold Mining Co. Ltd. — Bunker Hunt contributes [illegible] shares worth $2.[illegible]-million, Herbert Hunt contributes 15,[illegible] shares worth $[illegible].

Kloof Gold Mining Co. Ltd. — Bunker Hunt contributes [illegible] shares, worth $4.4-million, Herbert Hunt contributes 42,456 shares, worth $1.2-million.

President Brand Gold Mining Co. Ltd. — Bunker Hunt contributes 158,[illegible] shares, worth $9-million, Herbert Hunt contributes 31,747 shares, worth $1.3-million.

Southvaal Holdings Ltd. — Bunker Hunt contributes 137,[illegible] shares, worth $2.8-million, Herbert Hunt contributes 53,[illegible] shares, worth $1.1-million.

Western Areas Gold Mining Co. Ltd. — Bunker Hunt contributes [illegible] shares, worth $1.[illegible]-million, Herbert Hunt contributes 1,000 shares worth $9,000.

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[illegible]

Winkelhaak Mines Ltd. — Bunker Hunt contributes 176,077 shares worth $4.5-million, Herbert Hunt contributes [illegible] shares worth $[illegible].

President Steyn Gold Mining Co. Ltd. — Bunker Hunt contributes [illegible] shares, worth $[illegible]-million, Herbert Hunt contributes [illegible] shares worth $1.1-million.

The partnership documents indicate that a total of 41.9 million ounces of silver bullion and coins are being transferred into the partnership (not counting forward commitments), $[illegible]-million worth of which is said to belong to Bunker Hunt, and $[illegible]-million is said to belong to W. Herbert Hunt.

[illegible] Cited

According to reports, the assets transferred into the partnership are to be accompanied by $[illegible]-million in silver trading debt that the partnership is designed to restructure.

The loans to Placid Oil will be directly secured by Hunt family properties including securities, real estate and oil wells. The loan papers assign a value of $16.86 per ounce to the Hunt's silver holdings for valuation purposes.

In signing the partnership documents, the Hunts agreed that each partner "will use its best efforts not to permit any other partner (i) [illegible] investments or (ii) [illegible] any new positions in any commodity (including without limitation silver or any other precious metal) for any commodity or other future, forward or option contract, for any speculative purpose or otherwise other than investments in commodities necessary for the prudent operation in the ordinary course of business of the farm and ranching business of the limited partners ..."

AMERICAN METAL MARKET, JULY 15, 1980

DAILY NEWSPAPER — AIR DISPATCH

American Meta

VOL. 88, NO. 138 THURSDAY, JULY 17, 1980

THE POLITICS OF SILVER

Hunts 'Generous' Along Campaign Trail

By MARK [illegible]

WASHINGTON (FNS) — Several legislators who led congressional moves to stop the sale of government silver and to require the government to buy more of the metal have received campaign contributions from the Hunt family of Dallas.

One of the most persistent congressional apostles of silver, Rep. Larry McDonald (D; Ga.) in his last two election campaigns, has received more than $9,000 from members of the Hunt family, including Nelson Bunker and W. Herbert Hunt. McDonald also has received contributions from Donald and Scott Dial, two well-known silver speculators who currently are facing government charges of market manipulation.

Two Republican congressmen, who closely backed McDonald in legislative moves to change the government's silver policies, Rep. Richard Kelly (R., Fla.) and Rep. Steve Symms (R., Idaho) also have received campaign financing from the Hunt family. So has Sen. Strom Thurmond (R., S.C.), who spoke in the Senate against administration proposals to sell off strategic stockpile silver the General Services Administration says it doesn't need.

Rep. Symms' silver dealings and links to the Hunts were chronicled in an earlier AMM article (AMM, July 11).

Rep. Kelly, who earlier this week was indicted by a federal grand jury for allegedly receiving a $25,000 payment from undercover FBI agents in the Abscam investigation, served as Rep. Symms' foil when the Idaho congressman stood up in the House on July 28, 1978 and fought for an amendment to the Commodity Futures Trading Commission authorization bill which congressional critics labeled "the bail-out Hunt amendment."

AMM ANALYSIS

Fifth in a series

According to speeches on the floor of the House, Kelly had pushed the amendment in committee before Symms introduced it on the floor. The amendment would have stopped the CFTC from taking administrative proceedings against alleged commodity law violators if the case had already been rejected by a court.

The Hunts claimed this happened to them in the soybean case. The Symms-Kelly amendment failed on the floor, but Federal Election Commission re-

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Hunts 'Generous' Along Campaign Trail

(Continued from first page)

cords show that Nelson Bunker Hunt made a $5,000 contribution to Kelly's campaign two days after Kelly spoke up for the "bail-out" amendment on the House floor. When Rep. McDonald last year began his legislative maneuvers to stop strategic stockpile silver sales and to get the government to buy more silver, Symms and Kelly were both allies.

There was significant legislative activity relating to silver last year, as the metal began its steep climb in price from $6 per troy ounce to $48 per ounce Jan. 17 this year.

In the most notable development, Rep. McDonald led successful efforts to derail a bill approved by the Senate that would have allowed the GSA to sell off part of the government's strategic silver stockpile. In 1978, the government had proposed selling off 62.5-million ounces of the metal; that figure later was cut to 15-million ounces when fears about market disruption emerged.

Some Politicians Objected

But some politicians objected to this more modest proposed sale, and two right-wing senators, Jesse Helms (R., N.C.) and Thurmond (R., S.C.) requested the General Accounting Office, a watchdog agency, to give an independent assessment of the government's strategic silver needs.

The GAO report, completed in April 1979, confirmed what the government's executive agencies had been saying since 1973: that 139-million ounces of silver currently held in the strategic stockpile were excess to potential needs in wartime. The Senate last October approved an administration bill authorizing the sale of 15-million troy ounces of silver. At the time of the vote, Sen. Thurmond indicated that despite the results of the GAO report he commissioned, he still opposed the silver sale, though he wouldn't object to the bill.

On the House Side

On the House side, meanwhile, Rep. McDonald was actively working on silver legislation. One bill, introduced by McDonald on June 28, 1979, with Symms, Kelly and several other cosponsors, would have required the government to purchase $312-million worth of silver for the stockpile.

That bill was effectively shelved by a House subcommittee in December 1979, but only after two hearings, one of which ended in acrimony.

At the first hearing, on July 31, 1979, General Services Administration and Federal Emergency Management Agency officials testified, reiterating the government's position that there were 139-million troy ounces of excess silver in the stockpile, and that the government certainly didn't have to buy more.

On Nov. 28, 1979, the same House subcommittee invited McDonald to present his case for the $312-million silver purchase. As expert witnesses backing his testimony, McDonald brought with him Paul Sarnoff, director of research at ContiCommodity Services Inc., and Scott Dial, who along with his brother Mark Dial, had been suspended by the Chicago Board of Trade for 15 days in August 1979 for systematically trading against the positions or orders of their customers.

Hearing Ended in Uproar

The hearing ended in an uproar when Rep. Silvio Conte (R., Mass.) brought up Dial's disciplinary record and said: "This morning the price of silver in the London exchange jumped more than a dollar to nearly $18 an ounce, and this is due to reports the U.S. is going to increase its silver stockpile.

"I don't know who is putting out these reports, but if they are basing them on the fact we are having a hearing this morning in the Capitol, they are dead wrong," Rep. Conte said.

"If this subcommittee gets the idea that persons involved in the silver market are attempting to manipulate the market based on totally erroneous reports of our intent on this bill, then we have to have a highly competent investigative staff to look into the subject."

The day of his testimony, Scott

Dial gave McDonald a $1,000 campaign contribution. Scott's father, Don Dial, had given McDonald another $1,000 in January 1979.

While the testimony was to no avail, McDonald had more success on Dec. 12, 1979, with an amendment to the House stockpile bill, which was to match the Senate bill which provided for a 15-million troy ounce silver stockpile sale and which was approved in October. McDonald proposed, and succeeded in winning, a vote by the House to delete any silver sale provision from the stockpile bill. The Senate eventually agreed to the House's decision that no silver be sold.

McDonald's campaign financing records, filed with the Federal Election Commission in Washington, show that in addition to $2,000 in contributions from the Dials, McDonald's 1980 election treasury has been patronized by at least $4,000 in contributions from Hunt family members, and another $3,500 in contributions from officials and relatives of officers of North American Coin & Currency Ltd., a Phoenix, Ariz. coin dealership.

In 1977-78, records show, McDonald received $5,000 in contributions from the Hunts and $7,750 from individuals connected with North American Coin & Currency.

In both 1975 and 1979, according to records McDonald filed with the House of Representatives, he accepted travel, food or lodging expenses from the Phoenix firm in 1979 he also accepted a $807 honorarium from the company.

Members of John Birch Society

In addition to their common interest in silver, Bunker Hunt, McDonald and Scott Dial all are active members of the right-wing John Birch Society. S.J. Agnew, a director of North American Coin & Currency, is on the board of advisers of the society's journal, American Opinion, and McDonald and Hunt are both members of the society's governing council. McDonald has inserted items in the Congressional Record favorable to the Hunts.

But Tommy Toles, a spokesman for McDonald, insisted there was "no significance" to the campaign financial or political connections between McDonald and the Hunts or other silver investors.

"He doesn't introduce special interest legislation at all," Toles said. He said McDonald didn't discuss his silver bills with anyone outside Congress before introducing them. He said there was no particular close amity between McDonald or Bunker Hunt, although "obviously they're acquainted."

Scott Dial, a self-described "life member" of the Birch society, said that while he occasionally contacted McDonald's office for information about congressional activity, he didn't know McDonald was introducing his silver purchase bill until he read it on a news wire.

Dial, who said his father had been instrumental in interesting Bunker Hunt in investing in silver, acknowledged acquaintanceships both between the Hunts and the Dials and Bunker Hunt and McDonald. But he said he knew McDonald had "dozens" of contacts in the metals industry upon whom the congressman could rely for information about the market and government needs.

Dial also said his family intended to "contest the hell" out of Commodity Futures Trading Commission charges currently pending against Donald and Scott Dial. The CFTC, in an administrative complaint, has charged the Dials with a scheme to manipulate the silver market in November 1978, using a $20-million check from a Pakistani businessman which later bounced.

As for comments from some of the other legislators who have supported McDonald's silver bills and received money from the Hunts:

- Ed Kinney, a Senate Armed Service Committee staff member who works for Thurmond, said to link Hunt contributions to Thurmond's legislative behavior would be a "very low blow." Thurmond's election financing reports show he received $4,500 in Hunt family contributions for the 1978 primary election campaign.

But Kinney said the last time Thurmond met a Hunt face-to-face was nine years ago, when the late H.L. Hunt visited the senator's office asking to use his telephone. The Hunts, Kinney added, had "routinely" contributed to Thurmond's campaign for "many years."

- A spokesman for Rep. Kelly of Florida, said that as far as he knew Kelly and the Hunts were not close and in fact he was not aware that Kelly had ever met any of the Hunts. He said he had no response to questions about Kelly's involvement in the "bail-out Hunt bill" debate or the fact that Kelly had received a campaign contribution from Nelson Bunker Hunt shortly after the debate.

POTOMAC PULSE

By [illegible]

Hunts' Lobbyist Linked To '78 CFTC Amendment

WASHINGTON (FNS)—Two Republican Congressmen apparently promoted a 1978 amendment that would have cut back the Commodity Futures Trading Commission's enforcement powers at the direct request of Nelson Bunker Hunt's Congressional lobbyist, it was learned.

Reps. Steve Symms (R., Idaho) and Richard Kelly (R., Fla.) also received campaign contributions from the Hunt family in close proximity to their [illegible] on the amendment, Federal Election Commission records show. The two congressmen never publicly acknowledged any connection between the Hunt family and the controversial amendment, however.

The amendment would have prevented the CFTC from taking administrative action against any alleged commodity law violator whose case had been thrown out of court.

In a May 23, 1978, Senate Agriculture Committee discussion on the bill, then-CFTC Chairman William Bagley commented, "I am not characterizing this attempt, but over a period of months there has been an attempt to [illegible] the Hunt case." In that case the CFTC sought first judicial, and later administrative, remedies against alleged Hunt family attempts to evade speculative position limits on soybean futures contracts.

Restrictions Sought

During the 1978 Congressional debate on CFTC reauthorization, the Hunt family at first sought congressional redress for the CFTC's alleged harsh treatment by asking the Senate Agriculture Committee to put new restrictions on the regulatory agency. W. Herbert Hunt appeared before the committee to criticize the CFTC. Later, two conservative senators, the late James Eastland (D., Miss.) and Jesse Helms (R., N.C.) sought to include language favorable to the Hunts, first in the new CFTC bill and later in the Senate committee report on the bill. Both proposals were rejected at [illegible] agriculture committee meeting on April 25, 1978.

When the CFTC bill was debated in the relevant House Agriculture subcommittee a few days later, Kelly offered an amendment to the measure similar to the Eastland and Helms language. But Kelly made no mention of any connection between his amendment and the Hunts and no member of the Hunt family appeared before the House panel or associated themselves publicly with Kelly's efforts, or later efforts by Symms to keep the pro-Hunt amendment alive on the House floor.

An aide to Symms denied that Symms had discussed the amendment with the Hunt family before speaking out for the measure.

But AMM has learned that the Kelly-Symms amendment, dubbed the "bail-the-Hunt-in-the-future" amendment in a House floor debate in July 1978, was directly inspired by a former public relations consultant named Claude Pinel. At the time he was pushing the bill, Pinel was registered with the House of Representatives as Nelson Bunker Hunt's representative on matters relating to the CFTC reauthorization bill.

Registered Lobbyist

Pinel also was registered as a lobbyist for Hunt International Resources Corp., a Hunt family holding company which, among other things, owns Great Western Sugar Corp., the nation's largest sugar beet processor. And AMM has established

(This story follows an [illegible] of the [illegible] of Silver [illegible] published July 8-[illegible] in American Metal Market.)

that Symms in May 1978 introduced a bill written by a lawyer for Great Western Sugar that would have protected the Hunt-controlled firm by allowing it a fixed share of the United States sugar market.

In addition to receiving campaign contributions from the Hunt family, Symms' office acknowledged that, since late last year, Nelson Bunker Hunt has been a member of the National Finance Committee in Symms' campaign to unseat Sen. Frank Church (D., Idaho). As reported, Symms acknowledged having speculated in silver at the time he cosponsored legislation potentially affecting the silver market, although he said he wasn't aware that anyone would regard this as a potential conflict of interest (AMM, July 11).

Kelly recently was indicted in the FBI's "Abscam" investigation for allegedly taking a bribe from undercover federal agents.

According to David [illegible], a former legislative aide to Kelly who handled the controversial CFTC amendment for the congressman, Pinel was referred to Kelly's office by Symms' office. [illegible] said Pinel, who introduced himself to them as a lobbyist for Great Western Sugar, was referred by Symms' office to Kelly because Kelly was a member of the House Agriculture Committee's conservation and credit subcommittee, which had direct jurisdiction over legislation affecting the CFTC. Symms is a member of the agriculture committee, but doesn't sit on the subcommittee.

Amendment Outlined

[illegible] said Kelly instructed his staff to prepare a draft amendment according to specifications laid down by Pinel. [illegible] said Pinel never acknowledged any connection with Nelson Bunker Hunt; the former aide said he didn't know whether Kelly knew of the connection between Pinel and Hunt.

Kelly made his first move to attach Pinel's amendment to the CFTC reauthorization bill at an April [illegible], 1978, Conservation and Credit subcommittee meeting. The amendment lost by a 7-3 vote. The Hunts weren't mentioned during the debate.

Kelly tried again at a House Agriculture Committee meeting on May 10. This time Symms joined him in speaking in favor of the amendment. Again the Hunts were [illegible] favored by the bill's backers. But this time the vote was 58-4 against the amendment.

Two days later, Symms introduced a bill titled the "National Sweetener Act." Drafted by Mark Sandstrom, a Washington attorney for Great Western Sugar, this bill, according to Great Western Sugar's then-vice-president, Clarence Davis, was designed to protect Great Western and other beet sugar producers by setting government quotas on the amount of corn sweeteners that could be produced each year by U.S. companies. The sweeteners were regarded as a threat by both beet and cane sugar producers. The Symms-Great Western bill never got anywhere.

Campaign Contributions

Federal Election Commission records show that immediately before Symms' activity on both the CFTC reauthorization amendment and the sweetener bill, the Idaho congressman had received campaign contributions from at least three members of the Hunt family. On March 29, 1978, W. Herbert Hunt contributed $1,000 to Symms' primary campaign fund; on April 7, Bunker Hunt made a similar contribution; and on April 24, Al G. Hill, a brother-in-law to the Hunts, contributed $500.

Symms took up the Hunt 'bail out' amendment from Kelly when the CFTC reauthorization reached the House floor. But the measure was soundly rejected by the House. Two days after the final floor debate, Kelly received a $1,000 campaign contribution from Nelson Bunker Hunt.

In a telephone interview, Fleet confirmed he had spoken to both Symms' and Kelly's offices about the Hunt-CFTC amendment, although he wouldn't detail the substance of the contacts. He indicated he also had helped get Symms to introduce the National Sweetener Act. He said he had discussed both the sweetener bill and the CFTC amendments with members of the Hunt family before lobbying for the measures.

Fleet also said the CFTC bill was his main lobbying project in 1978 as Bunker Hunt's personal representative. Reports filed by Fleet with the clerk of the House indicate that, in connection with his lobbying for Bunker Hunt during the first nine months of 1978, Fleet spent $[illegible] on such items as airline tickets, accommodations, and dinners. Fleet's reports show he worked during the period on two other bills for Hunt: one involving the silver stockpile and the other off-track betting. But Fleet acknowledged his work on these bills was relatively minor and that most of the expense money went on lobbying for the CFTC bill amendment.

Discussion Denied

A spokesman for Kelly declined comment on Kelly's involvement with Hunt-related legislation or the Hunt family or its representatives. He had no immediate comment on the latest allegations.

Symms' administrative assistant, Chris Lay, initially denied Symms had discussed the CFTC amendment with the Hunts. Confronted with the accounts of Fleet and Keshgarian, Lay still contended Symms never discussed the bill with anyone named Hunt (there is no evidence to the contrary). Lay said when he originally denied any connection between the Hunts and the CFTC amendment, he was referring only to members of the Hunt family. Lay said he still couldn't confirm any details of contacts between Symms' office and Fleet on the CFTC amendment.

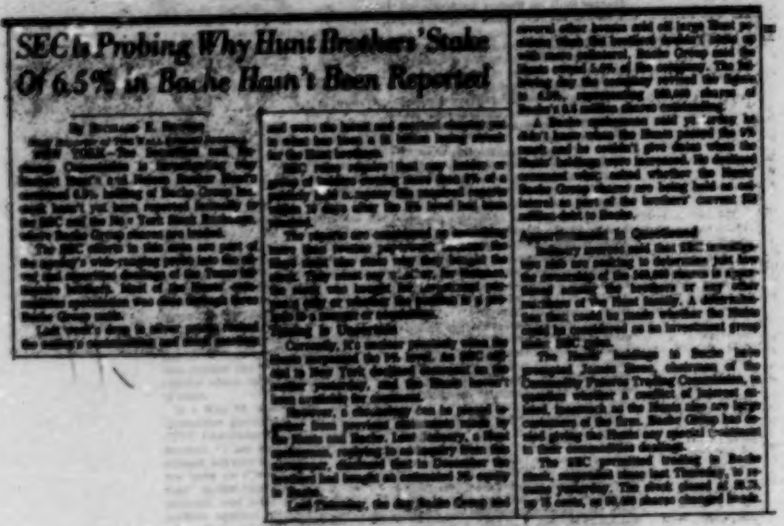
Lay acknowledged recalling that Symms' office had talked to Fleet about the national sweetener bill; but both Lay and Fleet said Symms' constituency was an important sugar beet-growing region. Clarence Davis, the Great Western Sugar official involved with the sweetener bill, said Symms only moved on the measure after consulting various beet growers in Idaho. (Fleet and Davis also noted that, in the Senate, the identical sweetener bill was introduced by a Democrat, Colorado Sen. Floyd Haskell.)

Asked about the apparent closeness of Hunt campaign contributions and Symms' actions on Hunt-related bills, Lay commented: 'When somebody gives us money that doesn't mean we buy their philosophy.'

American Metal Market
A FAIRCHILD BUSINESS NEWSPAPER

AMERICAN METAL MARKET, AUGUST 1, 1980

April 3, 1980 WSJ



SEC Is Probing Why Hunt Brothers' Stake Of 6.5% in Bache Hasn't Been Reported

2 Hunt Creditors Paid $12 Million

By Jerry Knight and
James L. Lowe Jr.
Washington Post Staff Writers

The Hunt brothers of Texas have paid more than $12 million to settle two additional silver speculating debts and have sold off some 250,000 shares of Penn Central Corp. stock they bought just before silver prices collapsed.

Two of the Hunts' creditors, Paine Webber Jackson Curtis Inc. and A. G. Edwards & Son, reported receiving payments from the Hunts yesterday. The Penn Central transactions were revealed in reports to the Securities and Exchange Commission.

Paine Webber announced it received $8.6 million to meet deficits in "two large commodity accounts," that were acknowledged privately to belong to Nelson Bunker Hunt and his brother W. Herbert.

Edwards, a St. Louis commodity specialist, said the Hunts have paid it more than enough money to settle a $4 million debt.

The companies that have publicly acknowledged the Hunts owed them money now all say the billionaire brothers have paid or arranged to pay all they lost when silver prices plunged from $50 an ounce to $10.80.

When silver prices hit bottom on March 27, the Hunts were unable to come up with hundreds of millions of dollars they owed commodity trading firms. At the time it was feared losses on the Hunts' accounts might force some of the companies into bankruptcy.

This week federal regulators told congressional investigators no firms are in trouble any longer because of dealings with the Hunts.

Paine Webber officials had originally projected a potential loss of [illegible] million on the Hunts account. That was the amount still owed after all the Hunt's investments in silver futures contracts had been sold.

A final accounting reduced the deficit to $8.6 million and the cash was wired to Paine Webber Tuesday night. Edwards got its money several days ago.

The Hunts have been forced to sell off other investments purchased when silver prices were rising to pay their losses once silver started to slide.

In an SEC report, Nelson Bunker Hunt said he had purchased 432,900 shares of what is left of the Penn Central Railroad and preferred stock convertible into 565,000 shares.

As of Jan. 17—a few days before silver prices started to fall—they owed more than 5 percent of the company, Hunt reported. Later in the day Penn Central reported Hunt had sold at least 250,000 shares, worth $3.75 million.

The Hunts are still believed to owe about $10 million to Bache Halsey Stuart Shields Inc. and other subsidiaries of the Bache Group Inc. Bache says the Hunts have agreed to pay when a final accounting is completed at the end of the month.

Bache has already collected about $40 million from the brothers and sold off Hunt holdings to pay other debts.

The brothers' biggest reported settlement was with Engelhart Minerals & Chemicals. The Hunts gave them Canadian oil and gas wells estimated to be worth $400 million and 265 tons of silver to settle a debt.

Another big Hunt creditor, ACLI International, said last week it has "no problems with the Hunts" who reportedly borrowed $123 million from the firm to finance silver speculation. ACLI is headed by Adrian C. Israel, chairman of People's Drug stores of Washington.

MARKETS & INVESTMENTS

How Bache's jitters proved costly

As the Bache-Hunt silver debacle moves into stage two—lawsuits against both Bache Group Inc. and Nelson Bunker Hunt, increased scrutiny of the affair by federal regulators and securities industry officials, and growing turmoil within Bache itself—a clearer picture is emerging of what made the whole thing possible. And that picture, according to sources, clearly centers on the executive suite at Bache, and especially on the firm's chairman, Harry A. Jacobs Jr. "His all-consuming fear has been that another firm would take over Bache," says a former official. "He was afraid that he would not last long if that happened." Now, as an aftermath to the silver debacle, changes are indeed likely in the Bache management lineup.

Jacobs, who last summer signed a $190,000-a-year employment contract that runs into 1982, was worried about a possible takeover attempt by the Belzberg brothers of Canada, who purchased 7% of Bache last year. And insiders concede it was this concern that touched off the series of events culminating in the recent collapse of the silver market, enormous paper losses for the Hunt brothers, and heavy initial losses for Wall Street investment houses.

In the fall of 1979, Bache proposed to its shareholders that the company's bylaws be changed so that a 75% vote of holders be required to remove a member of the board of directors. It also suggested a restructuring in the election process so that directors would be elected on a staggered basis. The measures were approved last November, making it next to impossible for any entity to wage a hostile assault on the firm.

'Peanuts.' Jacobs, 58, apparently continued to fear the Belzbergs, however—possibly because of the growing feeling on Wall Street that the new antitakeover measures would not stand up in court—and decided on some further insurance. Insiders say that Jacobs asked Charles Mattey, Bache's top commodities broker, to approach Bunker Hunt and his brother, William Herbert Hunt—who were using Bache as one of their primary futures brokers for years—to buy a hunk of Bache stock to discourage the Belzbergs. The Hunts agreed, and in late 1979 they began buying what became a 6.5% interest in the firm. "It was a peanuts investment for the Hunts—no more than $5 million," says another source. "And for that few million dollars they had Harry Jacobs indebted to them."

Jacobs' concern about a possible takeover, in fact, predates the Belzbergs. In 1978, the year after Jacobs became chairman, he was apparently fearful that trustees for a 6% block of the firm's shares from the estate of Chicago bond dealer Harold Brady might join forces with Gerry Tsai, one of Wall Street's best-known go-go managers during the 1960s. In a private transaction that June, Bache bought some 500,000 shares belonging to the Brady estate and Tsai, at a premium of more than 20%.

Jacobs' overture to the Hunts, sources say, was also motivated by his dismay over a research report on the firm that criticized Bache's operating performance. The report, which came out last June, was authored by analyst Perrin H. Long Jr. of New York-based Lipper Analytical Distributors Inc. In it, Long scored Bache's dependence on interest income generated by lending activities—rather than operating income from the sale of securities—as well as the firm's low sales production per employee.

It immediately became clear within Bache that Jacobs was upset over the report, and a campaign to boost sales production was launched. (At the November, 1979, annual meeting, in fact, Bache President H. Virgil Sherrill told holders that the firm was going to intensify its efforts to boost production in the coming year.) One way to accomplish this, sources say, was for Bache to take on business that others were turning away. Some of this was an increase in Hunt silver dealings, specifically some accounts that became available when the Shearson-Loeb Rhoades merger was completed.

The affiliation with the Hunts—already enormous—grew larger, apparently with the added aim of boosting Bache's per-employee production. At an executive committee meeting in early March, Jacobs and other Bache officials extended a $230 million loan (backed by silver warehouse receipts) to the Hunts. The money was obtained by a Bache unit (and guaranteed by the parent) from 10 banks, in apparent conflict with the Federal Reserve's credit-tightening measures, especially as they applied to speculative purposes.

While Bache is apparently getting its house in order after the initial shocks of the Hunt affair, many problems still loom on the horizon, including increased interest by federal regulators, Congress, and even the New York Stock Exchange. Moreover, within Bache, employees are already falling into pro-Jacobs and anti-Jacobs camps. "The rawest nerve is what's going to happen to top management," says an insider. "Everybody is looking for somebody to point at." ■

Crackdown Feared

Hunts Shifted Silver Abroad

Friday, April 18, 1980

By Jerry Knight
Washington Post Staff Writer

Fearing the United States might crack down on silver hoarding, the Hunt brothers of Texas last fall quietly began transferring some of silver out of the country.

In one trans-Atlantic transaction alone, the Hunts shifted two million ounces of silver from Chicago to a Swiss bank, according to documents made public by the Commodity Futures Trading Commission.

The CFTC memos reveal for the first time how the Hunts bought and sold billions of dollars worth of precious metals, often working in partnership with two Saudi Arabian sheiks.

Nelson Bunker Hunt never even met one of the two Arabs, he told federal authorities last fall. Negotiating by telephone, Hunt and the Saudi stranger formed a corporation in Bermuda to buy silver, gold, an oil refinery and a copper mine.

The talks between the Hunts and federal regulators showed that restrictions . . . did nothing to stop the Hunts' silver-buying spree.

Another previously undisclosed Hunt deal involved the purchase of 40 million ounces of silver—almost five percent of all the silver used in the United States in a year.

The Hunts discussed their massive silver purchases openly with federal commodity regulators, at the same time urging the government not to interfere in the silver market, the CFTC memos disclose.

CFTC officials were so alarmed by the Hunts' dealings that as far back as September they warned the Federal Reserve Board and the U.S. Treasury Department of irregularities in the silver market.

The Federal Reserve and the Treasury ignored the warnings, say memos written by Read P. Dunn Jr., the CFTC commissioner who acted as liaison with the other agencies.

"They showed no particular interest in silver," noted Dunn, a meticulous memo-writer who made notes on dozens of meetings about silver in the last year.

Dunn released some of his files yesterday, after sending them to Rep. Benjamin Rosenthal (D-N.Y.), chairman of a subcommittee investigating the collapse of the silver market.

The documents turned over to Rosenthal include memos by Dunn and CFTC staff members on meetings and phone conversations they had with Nelson Bunker Hunt.

At a meeting on October 25, Hunt said, "he tended to prefer silver located in Europe," wrote John Mielke of CFTC's division of economics.

"He (Hunt) said he was afraid the U.S. government might expropriate silver from individuals as it did in the 1930's, when individual citizens were no longer permitted to own gold," Mielke's memo said.

To avoid the cost and risk of shipping tons of precious metals overseas, Hunt worked out trades with foreign silver owners who wanted to sell their metal in the United States.

Working with J. Aron & Co. of New York, Hunt in October agreed to trade two million ounces of silver he owned in Chicago for two million ounces Aron owned in Zurich, Switzerland. In another trade, the Hunts got five million ounces of silver from Sharps, Pixley, a London metals dealer, in exchange for U.S. silver futures contracts.

In his discussions, Hunt talked of other deals worked out, he said, by his brother W. Herbert—another two million ounces from Sharps, Pixley; 3.5 million ounces from Ralph Peters, a big Chicago commodity trader; and a series of transactions that netted 9.2 million ounces of silver for International Metals Investment Company, the partnership formed with the two Saudi Arabians.

Mielke's memo identifies the Saudis as Ali Bin Mussalliam and Mohammed Aboud al-Amoudi, the man Bunker Hunt said he had never met, but with whom he shared millions of dollars worth of investments.

The talks between the Hunts and federal regulators showed that restrictions imposed on the silver futures market at the urging of the CFTC did nothing to stop the Hunts' silver-buying spree.

When limits were imposed on the number of silver futures contracts any single investor could own, the Hunts stopped buying their silver in the futures market and got it from U.S. metal dealers in London.

When the downpayment on silver futures contracts was raised to 40 percent, the Hunts found they could finance cash purchases with only 20 percent down.

Bunker Hunt complained to federal officials that the two restrictions were imposed by the Chicago Board of Trade and the New York Commodity Exchange because exchange officers stood to profit from falling silver prices.

Possible conflicts of interest at the CBOT and Comex are among the issues being investigated by the CFTC and congressional committees.

The CFTC, sources there said yesterday, has authorized its staff to subpoena the silver records of 10 companies and eight individuals including Bunker and Herbert Hunt and three of their married sisters, Elizabeth, Mary and Ellen.

Rosenthal's subcommittee has scheduled a vote next Tuesday on whether to subpoena the two Hunt brothers. Rather than talk to Rosenthal's subcommittee, the Hunts reportedly are considering accepting an "invitation" to appear before the Senate Agriculture Committee.

Volcker Reportedly Aided Hunts in Obtaining Loans

4/24

By JAMES FLANIGAN
Times Staff Writer

Under the guidance of Federal Reserve Chairman Paul A. Volcker, a group of the nation's largest banks agreed in recent weeks to lend up to $800 million to the Hunt brothers of Dallas to halt a chain of events that Volcker and other officials feared might lead to an economic panic, informed sources told The Times Wednesday.

It is understood that the Hunts so far have borrowed $[illegible] million to pay off maturing debts on silver. In future months, as more of the Hunts' past contract promises to buy silver come due, they are expected to use much of the rest of the $800 million credit.

Details of the massive credit were worked out by Volcker and other top government officials with the chief executives of some of the nation's largest banks, who met secretly with the officials at the Federal Reserve headquarters in Washington.

The fear of federal officials, and bankers, according to the sources, was not that the multimillionaire Hunts were broke. It was that the brothers—Nelson Bunker and William Herbert Hunt, whose speculations in silver have become famous worldwide—could not come up with cash quickly enough to satisfy contracted obligations to buy the metal.

This would have led to defaults, thus further depressing the price of silver, which has gone in less than three months from a peak above $50 an ounce to current levels around $12 per ounce.

Defaults could have caused financial difficulties for brokerage houses through which the silver contracts were made. New declines in the metal's price would have hurt banks that have lost money on silver. And, as they have before, reports of difficulties for the wealthy Hunts could have led to panic selling in the stock market.

Please Turn to Page 16, Col. 1

VOLCKER AID TO HUNTS REPORTED

[illegible]

Volcker wangles an $800M marker for the high-rolling Hunts

By JAMES FLANIGAN
Los Angeles Times

FEDERAL Reserve Chairman Paul A. Volcker has helped arrange a loan of up to $800 million to the Hunt Brothers of Dallas by a group of the nation's largest banks.

The move was made to halt a chain of events that Volcker and other officials feared might lead to an economic panic.

It is understood the Hunts so far have borrowed $300 million to pay off maturing debts on silver.

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New declines in the metal's price would have hurt banks that have lent money on silver.

And, as they have before, reports of difficulties for the wealthy Hunts could have led to panic selling in the stock market, with ripple effects throughout the economy.

Because the Hunts still must meet future obligations to purchase silver, federal officials could envision a monthly series of defaults and panics, each one building on the other.

PAUL VOLCKER
Fears chain panic.

NELSON BUNKER HUNT
Cash problems.

Volcker and the other government officials clearly saw the situation as more serious than their public statements in the last month have indicated.

There was fear, sources said, that the financial condition of some banks would be placed in jeopardy if the chain of events continued.

As a result of the bank credit — which was extended not directly to the Hunt brothers but to the Hunt family's Placid Oil Co. — the danger of disrupted markets appears to have passed.

One banking source said, "We haven't heard a peep" from the markets while the Hunts used $300 million to meet obligations.

The action to buttress the silver market was designed to forestall any recurrence of the incipient panic that hit the financial world on March 27, when news spread that the Hunts had refused to meet calls for funds to support loans from brokerage houses they dealt through.

The stock market plunged wildly on that day, amid fears that one or more brokerage houses would collapse.

The market recovered before the day was over as assurances were received that the brokerage houses would weather the storm.

BANKS NEGOTIATING BIG LOAN TO OFFSET HUNTS' SILVER LOSS

Lenders Fear That, Without Funds, Debt Problems Could Further Harm Financial Markets

By KAREN W. ARENSON

A group of major American banks, concerned that the financial position of the Hunt brothers of Dallas remains precarious, is actively negotiating a large loan with the Hunts to offset the hundreds of millions of dollars the brothers lost in silver trading in recent weeks.

The bankers fear that, without new financing, the Hunts may have difficulty in paying off other debts, and that such problems could touch off further chaos in the financial markets.

Banking sources said yesterday, however, that no new loan had yet been made. "There have been negotiations, but no terms have been ratified," a source at one large New York bank said.

Volcker Knows of Talks

The negotiations are taking place with the knowledge, and according to some reports, with the acquiescence of Paul A. Volcker, chairman of the Federal Reserve Board. Mr. Volcker has come out strongly in recent months against providing credit for commodity speculation.

In a statement issued yesterday, however, the Federal Reserve denied that Mr. Volcker had played any role in encouraging or approving of a loan to the Hunts, although the statement said that Mr. Volcker had stayed in close touch with developments.

"Contrary to published reports, neither the Federal Reserve nor its chairman, Paul A. Volcker, initiated any effort to obtain bank loans in connection with financial transactions of the Hunt brothers," the Federal Reserve said in the statement. "Banking officials have kept the Federal Reserve informed regarding such matters, but contrary to some reports the Federal Reserve has not approved any such loans."

Congressional Request Expected

A spokesman added: "No one has told the banks anything concerning either approval or disapproval. Mr. Volcker is in Europe now. We expect to be asked to testify before Congress. Until then, we have nothing else to say."

In response to published reports yesterday that the Hunts had secured an $800 million credit line from a bank consortium and had already used $300 million of the credit, the chairman of the House Banking Committee roundly criticized the Federal Reserve. Representative Henry Reuss, Democrat of Wisconsin, in a telegram to the Federal Reserve, said such bank loans "appear to be in clear violation of the Federal Reserve's direc-

Continued on Page D4, Column 3

—NEW YORK, FRIDAY, APRIL 25, 1980—

Banks Are Negotiating Loan to Hunt Brothers

Continued From Page A1

tive against bank lending for commodity speculation."

Mr. Reuss said he planned to hold hearings on the issue.

Banking sources said the report of the $800 million loan and use of $300 million of the credit was untrue. The Hunts' financial position deteriorated as the price of silver slid from more than $50 an ounce to $10.80 an ounce between January and March.

The disclosure on March 25 of the inability of Nelson Bunker Hunt and his brother W. Herbert Hunt to pay Bache Halsey Stuart Shields Inc. more than $100 million due on their silver futures accounts set off a short-lived near-panic on Wall Street. The size and worth of the Hunt holdings have never been confirmed by the brothers, and trade estimates have ranged widely from 100 million to more than 200 million ounces of silver.

When the Hunts first apprised top banking executives of their problems at a meeting in Boca Raton, Fla., on Sunday evening, March 30, they described the size of their debts as somewhere in the vicinity of $1.7 billion, some of which was backed by collateral.

Their settlements to date — to Bache; Merrill Lynch, Pierce Fenner & Smith; Paine Webber Inc.; A.G. Edwards & Sons, and the Engelhard Mineral and Chemicals Company — appear to total less than $1 billion, leaving open the question of what firms or banks hold the remaining debt.

The bank-rescue plan originated at a meeting of the Reserve Bankers Association, a group of leading representatives of Federal Reserve members, in Florida on March 29 and 30.

Call From Dallas

The bankers became involved in response to a call on Sunday, March 30, from Dallas, where officials of Engelhard, a major trading company, were meeting with the Hunts about the brothers' refusal to purchase 19 million ounces of silver at $35 an ounce that the Hunts had contracted to buy from Engelhard some months earlier.

The price of silver had plunged to $10.80 on Wednesday March 26 and rose to a range of $12 to $14 by Friday March 28. At a price of $35, therefore, the Hunts faced a loss of some $400 million if they fulfilled the contract.

During the meeting, the Hunts reportedly disclosed to the Engelhard officials how much money they had lost and how much they still owed. When the magnitude of the problem became clear, a participant at the talks called William Spencer, president of Citibank, who was at the Boca Raton bankers meeting, asking for help.

After a discussion, the Hunts and Engelhard officials flew to Boca Raton. By 10 P.M., Mr. Spencer had gathered about 10 top bankers to talk with the Hunts about their financial problems and to consider some kind of loan package. The idea was to provide a large loan to pay off all of the Hunts' smaller loans and allow them to raise more cash from their less liquid assets.

The loan under discussion now would not go directly to the Hunts, but would be given to the Placid Oil Company, which is owned in trust by all of the Hunt family. The money, however, would be for the use by the Hunt brothers who have incurred the large debts. The banks consider Placid a strong company and are apparently willing to take its assets as collateral for a loan.

Banking sources said that among those attending the late-night session were Mr. Volcker, who was also attending the association's weekend meeting; Walter B. Wriston, chairman of Citibank; Lewis T. Preston, chairman of the Morgan Guaranty Trust Company; Willard C. Butcher, president and chief executive officer of the Chase Manhattan Bank; John McGillicuddy, chairman of Manufacturers Hanover, and A.W. Clausen, chairman of the Bank of America.

At about 4 A.M., after hours of discussion by themselves over cold cheese sandwiches and coffee, the bankers called the Hunts and the Engelhard officials into the room and told them they were not ready to make a loan. In the hours that followed, the Hunts continued to negotiate with Engelhard and arrived at an agreement to turn over some $400 million in assets, including 8.5 million ounces of silver and a portion of their oil and gas properties in the Canadian Beaufort Sea, in exchange for canceling the 19-million-ounce silver contract.

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Friday, April 25, 1980

Fed Denies Approving Loan to Hunt Brothers Of Up to $800 Million

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON – The Federal Reserve Board denied it approved a large loan by a group of banks to help the Hunt brothers pay huge debts accumulated when the silver market collapsed last month.

The Los Angeles Times and The Washington Post reported Paul Volcker, the Fed's chairman, approved a plan for the banks to provide them as much as $800 million in credit. In a statement issued late yesterday, the Fed said it hadn't "initiated any effort to obtain bank loans in connection with financial transactions of the Hunt brothers."

It added that: "Banking officials have kept the Federal Reserve informed regarding such matters, but contrary to some reports, the Federal Reserve hasn't approved any such loans."

Several government sources, however, confirmed that such a line of credit is being worked on for the Hunts. It is understood the loans are being arranged by two major banks, First National Bank in Dallas and Morgan Guaranty Trust Co. of New York. However, "nothing has been completed yet, so there's nothing for Volcker or anyone else to approve," one government source said.

The Hunt brothers, Nelson Bunker and William Herbert, had speculated heavily in silver in recent years and had profited handsomely as the price soared to more than $50 an ounce from $8. However, the Texas billionaires were squeezed when prices began to fall. Last month, the price of silver collapsed when word spread that the Hunts couldn't meet a margin call for about $100 million.

The reports said the loan was arranged to avoid a chain reaction that could have caused brokerage houses and other institutions to tumble if the Hunts couldn't make good on the credit calls.

The reports that the Fed had aproved the loans touched off sharp criticism yesterday on Capitol Hill. Critics noted that last month, as part of an anti-inflation effort, the Fed moved to restrain the growth of consumer credit and warned banks about making loans for speculative purposes.

Yesterday, after refusing to comment on the published reports, the Fed issued its denial. The office of the Comptroller of the Currency, also named in the reports, wouldn't comment.

In Dallas, legal counsel for the Hunts said, "We just aren't talking to anybody" and refused to confirm or deny the reports. Officials at the Hunt family's Placid Oil Co., the reported recipient of the credit, were unavailable for comment.

In New York, some bankers said negotiations on a loan to the Hunts continued. "The situation is fluid," one said. Some banks in the potential lending group aren't satisfied with the proposed terms, he said. Because the Hunts haven't been clients of some of the large New York banks and because of their recent financial problems, the loan probably wouldn't be made without government involvement, the banker said.

A spokesman for another major New York bank said he understood the lending arrangement was to be completed this week and was for significantly more than $800 million. Other bankers either declined to comment or said they didn't know of a credit arrangement for the Hunts.

Credit Plan for Hunts Won't Fuel Speculation Fed Chairman Insists

By Sheilah Kast
Washington Star Staff Writer

Federal Reserve Board Chairman Paul A. Volcker said yesterday he would rely on "moral suasion" to make sure a proposed $800 million dollar line of credit to the billionaire Hunt brothers does not fuel more speculation.

Volcker told reporters in Hamburg, West Germany where he was attending the International Monetary Fund conference, that he was aware a consortium of U.S. banks has been arranging credit for the Hunts.

The Hunt brothers, who had speculated heavily in the silver market, have been pressed to raise cash since the value of their holdings collapsed as silver prices slid from a high of $52 an ounce on Jan. 21 to $10.80 on March 27.

Volcker said yesterday, "There is no truth in the statement that I initiated or guided" the loan agreement, which has not been signed yet.

But another U.S. official in Hamburg described a more active role by the Fed chief. He said Volcker asked a group of banks to see if they could help out the Hunts "in order to prevent the collapse of the financial markets."

However, the source said Volcker did not orchestrate the loan or "tell the banks what to do."

He added that the proposed loan agreement contains clauses designed "to keep the Hunts from using this money for further speculation."

Whether the line of credit will fuel speculation and whether Volcker played a role in arranging the credit are key questions, because as part of its anti-inflation policy, the Fed has been urging banks to refuse to make loans for speculative purposes.

Volcker and the Hunt brothers have been asked to testify before two congressional panels next week.

The largest Hunt settlement made public since the collapse of the silver market four weeks ago was the brothers' promise to turn over Canadian oil and gas leases, plus 300 tons of silver, to Engelhard Minerals and Chemicals Corp.

That exchange was to wipe out a contract requiring the Hunts on March 31 to buy 600 tons of silver for about $665 million — or $395 million more than its selling price on the silver market that day.

At the time, Engelhard said the additional silver and oil and gas leases "approximate" the $395 million difference.

Recent developments, however, throw increasing doubt on the deal to transfer about one-fifth of the Hunts' holdings in the Beaufort Sea, north of Canada. That may explain the renewed pressure to work out a line of credit for the Hunts.

A Canadian court has frozen the Hunts' assets in response to a suit by BP Exploration (Libya) Ltd. A spokesman for BP Exploration said his firm is trying to enforce a 1979 ruling by an English court requiring Nelson Bunker Hunt to pay about $80 million — a claim stemming from an earlier joint venture of Hunt and BP.

Lawyers are to argue that injunction before the Supreme Court of the Northwest Territories today.

Even if the court were to lift the injunction against the transfer of the properties, the Canadian government's Foreign Investment Review Agency expects to take several more weeks to decide whether it should launch a full-scale investigation of the Hunt-to-Engelhard transfer.

Such a review could delay a permanent transfer for two to four months, said Robert Stocks, FIRA's deputy director for compliance.

A third possible hitch in the deal, according to one New York banker, is uncertainty over the value of the Beaufort Sea drilling rights.

Saturday, April 26, 1980

Star

THE WALL STREET JOURNAL, Monday, April 28, 1980 3

Hunt Brothers, Family Mortgage $3.2 Billion Assets

Biggest Transaction Involves $2 Billion Note to Secure Loans to Meet Silver Debt

Three Hunt brothers and a family-owned oil company have mortgaged at least $3.2 billion of oil and gas properties, largely to meet huge debts incurred by the brothers during last month's silver-market collapse.

The Hunts say they are straightening out their tangled credit affairs on their own. But top U.S. government officials over the weekend indicated that the Federal Reserve Board has played an important role in encouraging banks to lend more money to the Hunts to prevent further reverberations in financial markets.

The mortgages relate primarily to properties in Louisiana, Mississippi and the Gulf of Mexico. The largest involves a transaction in which Placid Oil Co. signed a $2 billion note to secure loans from a group of banks headed by Morgan Guaranty Trust Co. and First National Bank in Dallas. Placid Oil, a Dallas-based energy concern owned by trusts set up by the late H.L. Hunt, pledged as collateral for the note "substantially all" of its oil and gas properties in Louisiana and the Gulf of Mexico, according to mortgage documents filed Friday in Jennings Parish, La.

This article was prepared by Wall Street Journal reporters George Getschow and Roger Thurow in Dallas and Philip Revzin in Hamburg, West Germany.

Placid's general counsel, Paul Hicks, said Placid has borrowed $750 million so far under the collateralized note of which more than $500 million has, in turn, been loaned to Nelson Bunker, W. Herbert and Lamar Hunt. He declined to specify the total amount that can be borrowed under the note, but said the maximum borrowing limit hasn't been reached.

In New York, a Morgan Guaranty spokesman confirmed yesterday the note arrangement with Placid Oil and said it represents "collateral for outstanding bank credit" to Placid that previously was unsecured. The spokesman wouldn't say how much the group of banks may eventually lend, or how soon.

Negotiations Explained

In an interview yesterday, Lamar Hunt–the sports entrepreneur whose name hasn't usually figured into the silver controversy–explained how the $2 billion mortgage was negotiated. He said it was arranged in private talks between the Hunt brothers, top Placid officials and a group of banks–including Morgan Guaranty and First National in Dallas, the Hunts' principal banks. However, Mr. Hunt denied published reports that Paul Volcker, chairman of the Federal Reserve Board, or any other government officials played any role in orchestrating the loan package.

"Volcker didn't have anything to do with it," Mr. Hunt declared. "We (the Hunt brothers and Placid) didn't even talk to him." Placid's Mr. Hicks said the loans were advanced to the three Hunt brothers "because they needed the money–they were having problems with their silver." He added that Placid "probably" will make additional loans to the Hunt brothers "to help them meet their silver debts."

Mr. Hunt asserts that, if anything, the Federal Reserve made it "virtually impossible" for the brothers to borrow money from banks to pay off their mounting debts. The Federal Reserve "put a clamp on us" by tightening its credit reins in the U.S. and "putting the strong arm on the major European banks," he said.

According to Mr. Hunt, that left the debt-ridden brothers little alternative but to seek help from Placid. "Placid was able to acquire the financing, but we couldn't because of the Fed's credit moves," he said.

Lamar Hunt and his brothers each own about a 22% interest in Placid; their sisters, Caroline and Margaret, are Placid directors and had to approve the loans. But Lamar Hunt said yesterday that any transactions he or his brothers have made with Placid "are on an arms-length basis." Margaret Hunt declined comment yesterday; Caroline couldn't immediately be reached.

Aware of Negotiations

Fed Chairman Volcker, interviewed in Hamburg, where he was attending a meeting of the International Monetary Fund's interim committee, said that he was aware of the negotiations for an $800 million loan to the Hunts but that "it would be wrong and

Hunt Brothers, Family Mortgage $3.2 Billion Of Oil, Gas Properties

Continued From Page Three

misleading to say that we (the Fed) organized or sponsored such a loan."

He added: "Our interest is the public interest, to make sure that any such loans aren't used for speculative purposes." Mr. Volcker said that "to my knowledge, the loan hasn't yet been completed."

"I have an awareness that there are loan negotiations under way, but there isn't any truth in the statement that I initiated or guided it," he declared. He added that "I don't want the money to end up in renewed speculation on silver markets," but he didn't give any details of the loan agreements or the specific ways the Fed might prevent that from happening. He said he would rely "on moral suasion" to see that the loan didn't fuel more speculation.

Other top U.S. government officials indicate that the Fed's role in getting things moving on the Hunt loan was somewhat larger than Fed officials have been willing to concede publicly. In essence, they say the idea was conveyed to the banks that the Fed thought it would be a good idea to help out the Hunts.

One government official said over the weekend that Mr. Volcker asked a group of banks several weeks ago to see if they could help the Hunts "in order to prevent the collapse of the financial markets." The official said that Mr. Volcker didn't orchestrate the loans or "tell the banks what to do."

The official added that the banks are taking precautions to make sure the Hunts don't use the money to take new positions in silver. The money is to enable the Hunts to "wind up their positions in silver" in "an orderly fashion," the official said.

Although the Fed generally shuns direct intervention in most bank-customer relations, there are ample historical precedents for the Fed's role in trying to help ease financial pressures triggered by the Hunts' woes.

During the past decade, the Fed often played a central role in financial rescue missions during periods of economic turmoil, or in individual cases involving unusually large amounts of money. Citing its role as "lender of last resort," the Fed usually acts because of a perceived need to prevent a blow to public confidence that could cripple the U.S. financial system, possibly to the point of causing chain-reaction collapses and a replay of the Great Depression.

Occasionally, the Fed acts behind the scenes, such as when officials quietly asked bankers during the early 1970s to help then-ailing real estate investment trusts. On other occasions, the Fed has intervened directly, such as its massive loans to Franklin National Bank in 1974. Franklin was kept afloat long enough for most of its assets to be acquired by European-American Bank & Trust Co.

The Hunts' silver woes sent shock waves through stock markets and commodities exchanges several weeks ago as the brothers scrambled to cover obligations on huge purchases of silver bought on margin. The price of silver plunged from a peak of just over $50 an ounce in January to under $11 late last month. Currently, it's just under $15 an ounce.

Loans secured with oil and gas properties have become fairly commonplace in recent years. In such cases, a bank will extend a loan based on a percentage of the estimated worth of the property put up for collateral, with the percentage depending on the property's potential.

Some observers familiar with the Hunt properties that have been put up as collateral question their worth, saying that some are old and others aren't yet producing. Lamar Hunt, however, said the properties are valuable, and that "there may be deeper drilling prospects in the long run."

According to other documents filed in Louisiana, Mississippi and Oklahoma, the Hunt brothers have signed over to Placid mortgage notes totaling more than $1 billion to secure loans from Placid. Separately, the Hunts have taken out mortgages totaling at least $150 million with First National Bank in Dallas. The purpose of the loans isn't specified in the documents, but most of the papers were filed March 25, shortly before the silver market collapsed.

Sam Henry, a vice president of First National Bank in Dallas, declined to discuss the mortgages yesterday.

American Banker MAY 1, 1980

Volcker: Bank Loans Stabilized Hunts' Position

Washington Bureau

WASHINGTON — The chairman of the Federal Reserve Board told a Congressional panel Wednesday that he could have stopped a group of banks from restructuring close to $1 billion of debt outstanding to the Hunt brothers, but he sanctioned the arrangement because "it was not contrary to the broad public interest."

The debt extended by the banks had the effect of stabilizing the financial position of Nelson B. and W. Herbert Hunt, wealthy speculators, who, according to Fed estimates, at one time in the last few months controlled close to two-thirds of all the silver held in private hands.

Paul A. Volcker, the Fed chairman, said "I had sufficient moral authority to stop the loan if I thought it was speculative." Mr. Volcker stopped short of saying the credits extended by the banks were not speculative.

Instead, he said that he allowed the banks to restructure these credits because the restructuring better protected the soundness of the Hunt creditors and because the banks agreed to add covenants to the new agreement that will restrict the ability of the Hunts to speculate in the future, he said.

Mr. Volcker reiterated after the meeting that while the loan agreements will be between the banks and Placid Oil Co., a firm controlled by the Hunts, he expects that arrangements between Placid and the Hunts will contain language designed to constrain the Hunts.

New Protection

"Assuming the negotiations are completed," he said, "we will have in place protection from renewed Hunt speculation."

Testifying before a House subcommittee here, Mr. Volcker said that he was asked prior to a March 30 meeting of the Reserve City Bankers in Boca Raton, Fla., whether a loan to aid the Hunts would be considered speculative under the Fed's guidelines against nonproductive lending.

Bankers and other sources contend that Mr. Volcker sanctioned an effort to assist the Hunts during a huddle with the family's major creditors in Boca Raton. But at the House hearing, Mr. Volcker did not say whether or when he ruled on the credit. Mr. Volcker acknowledged that he met with Hunt creditors in Boca Raton, but suggested that the meeting solely concerned a decision by the banks not to extend a specific credit at that time.

The Hunts are currently negotiating to restructure about $1 billion in outstanding debt, Mr. Volcker said. Mr. Volcker said that the majority of the silver contracts of the Hunts will be transferred to Placid. The oil company has agreed to pledge up to $2 billion of other assets as collateral for the loans that will aid the Hunts.

The bank group has assumed close to $500 million of margin debt extended by brokerage houses, along with over $100 million of personal loans to the Hunts and over $100 million of debt in the form of open contracts to purchase silver in the future.

Size Increased

In addition, the banks have recently increased the size of the proposed credit from $800 million to include the restructuring of some $200 million to $300 million of debt incurred by joint ventures between the Hunts and certain "foreign interests," Mr. Volcker said. During the hearings the foreign interests were said to be Saudi Arabians.

Mr. Volcker said that evidence suggests that the Hunts were attempting to corner the silver market. He said he has urged a joint study by several agencies to see if regulations can be passed which will restrict the ability of others to engage in similar efforts. He said the study should address such questions as how to effectively structure margin requirements, what capital requirements should be placed on middlemen in commodities and whether the government should place limits on the positions that traders can take. ■

Silver, Other Prices Slide on News Hunts Might Have to Sell

[illegible]

Silver and other commodity prices fell following indications from Federal Reserve Board Chairman Paul A. Volcker that the Hunt brothers may have to sell bullion to liquidate their silver debts.

Mr. Volcker told a House subcommittee that the wealthy Texans' attempts to refinance their silver debts "will enhance the prospects" of their holdings "being dispersed."

Silver for delivery this month on the Commodity Exchange in New York fell $1.77 an ounce to settle at [illegible]

Futures Markets

[illegible]

Mr. Volcker's statement "put the fear of God into just about everybody," [illegible]

[illegible]

Hunts Face Selling Much of Their Silver As Condition for Loans, Fed Officials Say

[illegible]

WASHINGTON—The wealthy Hunt brothers may have to sell much of their silver holdings, as a condition for getting banks to refinance their $1 billion-plus silver-trading debts, Federal Reserve Board officials said.

[illegible]

Mr. Volcker told the subcommittee, which is investigating last March's silver-market collapse, that the Hunts currently are negotiating with Morgan Guaranty Trust Co. of New York, and First National Bank of Dallas, among other banks, to repackage their massive silver-trading debts.

[illegible]

THE NEW YORK TIMES, FRIDAY, MAY 2, 1980

Business Day

The New York Times

10 Banks Lent Bache $233 Million

Funds Reported To Be *for* Hunts

By [illegible]

[illegible]

WASHINGTON, May 1 — [illegible]

[illegible]

[illegible]

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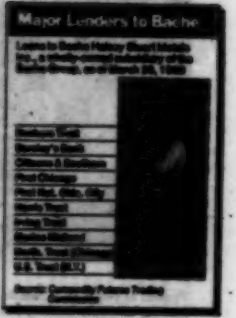


[illegible]

Bache Bank Loans Reportedly for Hunts

The New York Times/George Tames

Present at yesterday's Senate Agriculture subcommittee hearing on silver trading were, clockwise around table from left: David G. Gartner, Read P. Dunn Jr. (partially hidden), Robert L. Martin and James M. Stone of the Commodity Futures Trading Commission, Senators Donald W. Stewart and Richard G. Lugar (partially hidden), Deputy Treasury Secretary Robert Carswell and Paul A. Volcker, the chairman of the Federal Reserve Board.

ary, the Bache Halsey Stuart Metals Company, were from the U.S. Trust Company, Irving Trust, Bankers Trust, Marine Midland and Barclays Bank.

As the price of silver plummeted from more than $30 an ounce to only $10.80 an ounce during the last week in March, the value of the silver held by these banks began to fall below the size of the loans. All of the loans, however, were "demand loans," guaranteed by the Bache group, which is also the parent company of Bache Halsey Stuart Shields Inc., the brokerage firm through which the Hunts did much of their silver trading.

During testimony before the Senate agricultural subcommittee today, several Government officials spoke of their concerns over a possible domino effect of the silver trading.

Robert Carswell, Deputy Secretary of the Treasury, said that the possible impact of the Hunts' failure to meet their margin calls, "went well beyond the commodity markets." "Frankly," he added, "they [Bache] were on the high wire and there was no net there."

Hunt-Placid Oil Partnership Set

$750 Million in Silver Debts To Be Repaid

By KAREN W. ARENSON

Special to The New York Times

WASHINGTON, May 2 — The Hunt brothers are setting up a partnership between themselves and an oil company owned in trust for members of the Hunt family to pay off an estimated $750 million in debts incurred in silver trading, Nelson Bunker Hunt and W. Herbert Hunt told two Congressional panels today.

The partnership would repay the brothers' borrowings by drawing on a $1.1 billion loan to the oil company, the Placid Oil Company. For their part, the Hunt brothers would contribute a substantial part of their assets to the partnership.

The arrangement would apparently finally resolve the pressing financial difficulties that have plagued the Hunts since the near-collapse of the silver market in late March. In testimony before a Congressional committee yesterday, Paul A. Volcker, chairman of the Federal Reserve Board, said that when the loan was granted it would remove a danger that was currently hanging over the financial markets.

Bunker Hunt and Herbert Hunt testified before a subcommittee of the House Committee on Government Operations and later before a subcommittee of the Senate Agriculture Committee. Bunker, Herbert and Lamar Hunt will participate in the partnership with Placid.

Purpose of Partnership

"The purpose of the partnership is to provide a vehicle for management and orderly liquidation of the partnership assets," said Ivan Irwin Jr., an attorney for the Hunts and for Placid. "The intent is to do this at the earliest time [illegible]

silver, forward contracts for silver, shares of stock, coal properties and other unspecified assets, to the partnership. A Hunt attorney said the coal properties had an estimated worth of $250 million and were in North Dakota and Montana. Since many of these assets have already been used as collateral for loans from banks and brokerage firms, the debt that is attached to these assets will also be transferred into the partnership for immediate or gradual repayment.

Neither brother estimated the total value of the assets that he would be contributing to the partnership, but they said the equity value of the assets was about $450 million.

Herbert Hunt said he had about $400 million in debts and Bunker Hunt estimated that he had roughly $350 million in debts. Neither one gave the total value of the assets.

Herbert Hunt's Debts

Herbert Hunt said he owed about $100 million to the Swiss Bank Corporation of New York, $17.5 million to Citibank, and about $283 million to various brokerage houses, including Merrill

Placid Oil, Hunts Set Partnership

Continued From Page 29

Lynch, Pierce, Fenner & Smith Inc. and ACLI International Inc. Among the assets he listed were forward contracts for some 4.5 million ounces of silver in London and Switzerland and some unknown amount of silver bullion he holds abroad.

Bunker Hunt said he owed more than $100 million to the Swiss Bank Corporation and somewhat less than $100 million to ACLI. He said he had forward contracts in London for an estimated 2.5 million ounces of silver and that he had 3.5 million ounces of silver in Switzerland as well. The Hunts did not mention the fact that they had already borrowed more than $400 million from Placid. But this loan will reportedly be covered in the agreement as well.

The Hunts also noted today that the $1.1 billion loan to Placid was "negotiated." Final papers have not yet been signed, however.

"The loan is basically in place, but we have got to get the definitive documentation in place," Mr. Irwin said.

The Morgan Guaranty Trust Company and the First National Bank of Dallas are the co-managers of the loan. The other banks willing to participate in the consortium making that loan reportedly have been changing almost daily.

The Hunt brothers said the loan was for a term of nine years and would carry an interest rate of 1.5 to 2 points above the prime rate. It is to be secured by oil and gas properties owned by Placid that are estimated to be valued at well over $1.1 billion.

In their testimony and response to questioning before both panels, the two brothers emphasized that they traded independently of each other and of other members of the Hunt family, although they had offices in the same building, often had lunch with each other, and discussed what was happening in the market.

They maintained that if anyone had been hurt in recent months by the volatile silver market, it was they.

The partnership agreement the Hunts will have with Placid will bar them from acquiring additional positions in stocks or commodities, except if they need commodities or commodity provisions to maintain their farms. Once the assets in the partnership are disposed of, however, the partnership will dissolve and the Hunts will no longer be bound by such an agreement.

Placid Oil's Major Holdings

Oil and Gas Properties

- Texas: Placid is the principal operator of 42 leases in three regions. Placid produced 509,000 barrels of oil for the year ended April 1979 from the wells it operates alone.
- Louisiana: Placid is involved in the Black Lake field, one of the state's largest oilfields.
- Placid last year purchased reserves (most in Louisiana) amounting to 9.2 million barrels of oil and 99.3 billion cubic feet of gas from International Paper for $188 million.
- Gulf of Mexico: Placid holds leases on 99,000 acres in this region.

Interests in Energy Companies

- 11.3 percent of the Gulf Resources and Chemical Corporation, an energy and natural gas resources company.
- 9.2 percent of the Louisiana Land and Exploration Company, which has reserves of 100 million barrels of oil and 594 billion cubic feet of gas.
- 7.9 percent of U.N.C Resources, a large proucer of uranium.

Little-Known Concern Has Large Assets

Special to The New York Times

DALLAS, May 2 — Among oil companies, the Placid Oil Company is a giant that has received minimal publicity, even in the best of times. Its owners — six members of the Hunt family — apparently like it that way.

But with Placid's assets apparently being used to bail W. Herbert and Nelson Bunker Hunt out of large speculative silver losses, new attention has been focused on Placid and its vast natural-resource holdings. In Washington today, the Hunt brothers told a Senafe Agriculture subcommittee that they had $750 million in bank and brokerage house debt stemming from losses on silver.

The Placid holdings are large indeed — well over $2 billion, by at least one estimate. Placid has big holdings in Texas and Louisiana, two major producing states, as well as large holdings in the Gulf of Mexico. It has maneuvered into sites in the Rocky Mountains, the locale of a great energy rush. And it has bought large stakes in sizable publicly held companies with oil, gas and uranium holdings.

Only last February, before the current onset of silver troubles, Placid gave a demonstration of its financial resources when it proposed to pay more than $400 million to buy out the Gulf Resources and Chemical Corporation, one of the nation's largest energy concerns. That move came on the heels of a $188 million purchase last summer in which Placid enhanced its oil and gas reserves by buying major properties from the International Paper Company.

For a company of such size, Placid has operated relatively free from prominence, able to avoid attention mainly because it is privately held. It is owned by the six children of H.L. Hunt,

Placid Oil: Big in Assets, but Little Known Publicly

Continued From Page 29

the oil baron, and Lyda Bunker Hunt, his first wife. They own the energy company through trusts of approximately equal size set up in 1935.

(Another wing of the family from H.L. Hunt's second marriage controls a separate petroleum venture, the Hunt Oil Company. The Hunts' holdings in both wings now extend well beyond oil and include real estate, coal and even a chain of pizza restaurants.)

Placid's relative anonymity extends to its headquarters, in a downtown Dallas tower that bears the name of the First National Bank. The oil company, however, is building its own, more readily identifiable headquarters, a 50-story structure nearby.

The new tower will, of course, help to put Placid in the spotlight. But recent events have done much more to bring the company to national attention.

Holdings Pledged

Placid, to help Bunker and Herbert Hunt, has pledged most of its oil and gas holdings as collateral for its borrowings, previously uncollateralized, from a group of banks. The move apparently clears the way for Placid in turn to make loans to help the brothers meet losses they incurred when silver recently plummeted to slightly more than $10 an ounce from more than $50 an ounce.

It remains unclear whether Placid is entirely free to serve as the Hunts' private lender. In a recent interview, Ivan Irwin Jr., an attorney for the Hunt family, suggested it was not. He described Placid as insulated from control by family members.

Mr. Irwin said the company had "autonomous" officers, a board with a majority of outside members and a system of independent trustees and advisory committees. Attempts to reach Placid's president, C.D. Brown; the Hunt brothers themselves; Placid's attorney, Paul W. Hicks, or Mr. Irwin for further comment were unsuccessful.

Notwithstanding Placid's bent for privacy, it is possible to piece together a picture of its holdings from interviews within the financial community and from a variety of public sources, including the Bureau of Land Management, the Federal agency that keeps track of oil and gas leases on Federal property; the Securities and Exchange Commission, and court records.

Placid has substantial oil and gas holdings in Texas and Louisiana, two of the major producing states. Just last year, Placid added to these holdings by buying from International Paper oil and gas properties that contained proven reserves of 9.2 million barrels of oil and 83.3 billion cubic feet of natural gas. Most of these holdings were in Louisiana, International Paper said.

Ranked No. 100 in Texas

The Texas Railroad Commission, which regulates oil production in Texas, said Placid produced 380,000 barrels of oil for the year ended April 1979, ranking it No. 100 among roughly 7,000 oil producers in the state. Commission records show Placid as the principal operator of 42 leases where wells have been drilled in three regions: Houston, Corpus Christi and in northeast Texas. These records do not reflect, however, leases where Placid has yet to drill or ventures in which Placid has a partial interest.

In Louisiana, among other projects Placid is involved in the Black Lake field, one of the state's largest.

Placid also has substantial holdings in the Gulf of Mexico in areas of proven reserves. The Bureau of Land Management Office in New Orleans, which covers the Gulf and the South Atlantic Coast, said Placid held 22 leases in this region, where leases average 4,500 acres each. Placid owns five of the leases outright and has partial interests in 17 others.

The company also has other Gulf of Mexico holdings in the Mississippi River Delta off the coast of Louisiana. Though unproven, these holdings were described as promising by Geoffrey Hertel, a Houston oil analyst.

Joint Venture in Utah

The properties include a joint venture in and around Juab County, Utah, another area considered promising for exploration. The central Utah site is on Federal land leased by one of Placid's partners, the Williams Company, a Tulsa energy and chemical concern. According to a Williams spokesman, Placid is doing the drilling in return for half the revenues drilling produces. He described the area as part of the Overthrust Belt of the Rocky Mountains, which has become a hotbed of exploration.

Other holdings in Rocky Mountain states include 47 leases on Federal land in Wyoming, in which Placid has 100 percent control, and 16 leases where Placid has a part interest, the Bureau of Land Management's Wyoming office says. More than 30,000 acres are involved.

The Hunts' oil holdings are by no means limited to Placid. Bunker, Herbert and Lamar Hunt were recently identified as owners of Canadian Government exploration leases on 3.8 million acres in Canada's Beaufort Sea. The Engelhard Minerals and Chemicals Corporation is being given a 20 percent interest in these leases to settle a silver contract that the Hunts did not want to fulfill.

Placid is also involved in the energy-rich Canadian province of Alberta, where it holds 37 full or partial leases on 72,000 acres of Government land.

Placid has also actively sought interests in big publicly held energy companies. It has attained holdings in them through Placid subsidiaries, which have purchased large minority stock positions.

Placid owns 11.3 percent of the Gulf Resources, a Houston energy and natural gas resources company with $510 million in sales last year, according to an April 2 filing with Federal securities regulators. (A Gulf Resources spokesman said the holding had not changed since.) Gulf Resources has reserves of more than 17 billion cubic feet of gas and 475,000 barrels of oil.

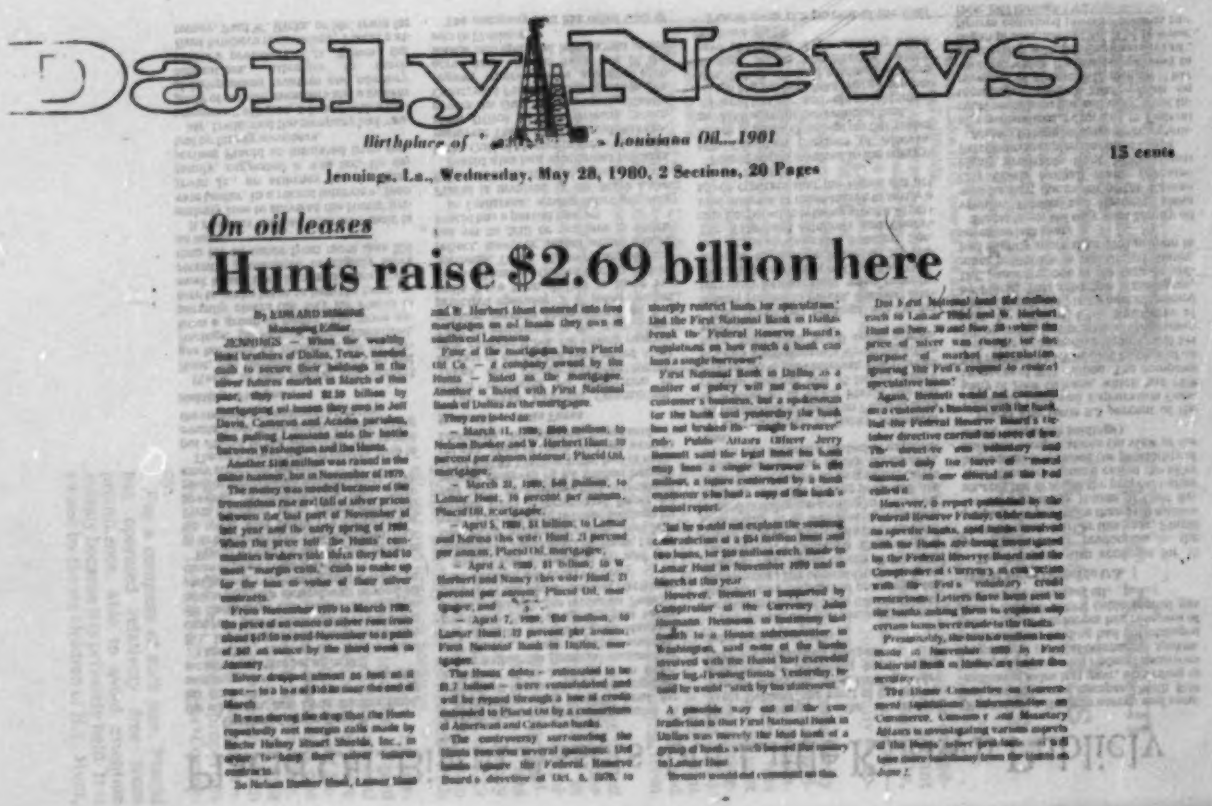
18% of Silver Output in U.S.

The company also accounts for 18 percent of silver production in the United States. Earlier this year, Placid proposed to pay more than $400 million for the remaining shares of Gulf Resources but dropped the proposal after Gulf Resources' board called the offer inadequate and raised the possibility of antitrust complications (in view of the Hunts' own silver holdings).

Placid also owns 9.2 percent of the Louisiana Land and Exploration Company of New Orleans, which had 1979 revenues of $817 million. The company has reserves of 100 million barrels of oil and other hydrocarbon liquids, and 304 billion cubic feet of gas, a spokesman said. In addition, UNC Resources of Falls Church, Va., is 7.9 percent owned by Placid. This suburban Washington, D.C., concern, one of the largest uranium producers in the United States, had slightly more than $280 million in revenues last year.

Placid is not the only joint-family oil venture. Bunker and Herbert, along with Lamar, the owner of the Kansas City Chiefs football team, operated highly profitable Hunt International Petroleum to explore for oil in Libya.

Although these holdings were eventually nationalized, according to Federal court records on file in Dallas, Hunt International cleared $180 million on revenues of almost $611 million. That venture, which the Hunts operated in partnership with BP Exploration Ltd., began production in 1967. The revenue figures contained in court records ran from 1967 through 1973.



Daily News

Birthplace of ' ... Louisiana Oil...1901

15 cents

Jennings, La., Wednesday, May 28, 1980, 2 Sections, 20 Pages

On oil leases

Hunts raise $2.69 billion here

Hunt Loans Will Settle Debt Abroad

By Jerry Knight
Washington Post Staff Writer

The controversial $1 billion loan to bail out the Hunt brothers of Texas after their silver-speculating spree will be used primarily to settle the Hunts' foreign debts, a Federal Reserve Board report on the loan discloses.

Almost two-thirds of the $1 billion will be used either to pay the Hunts' debts to foreign banks or to meet obligations of an offshore silver investment company, the report shows.

The billion-dollar bail-out loan has been negotiated with a group of major banks under the guidance of Federal Reserve Board Chairman Paul A. Volcker.

Volcker was drawn into the talks because he had urged banks not to make loans for speculative purposes, and the bankers were reluctant to lend so much to the Hunts without Volcker's knowledge.

Congressional critics have been complaining for weeks that the Hunts got their huge loan at a time when farmers and other businesses were having trouble borrowing to meet their normal credit needs.

The Federal Reserve defended its role in the Hunt loan in a long report sent to Senate Banking Committee Chairman William Proxmire (D-Wis.), who is holding hearings this week on the silver debacle.

The agency argues that because the loan "strengthens the position of creditors, it is not contrary to the broad public interest in the stability of financial markets and institutions."

Volcker and James Stone, chairman of the Commodity Futures Trading Commission, have testified repeatedly they feared that if the Hunts were unable to pay their debts, American banks and brokers would get in financial trouble and the panic might spread throughout the economy.

Most of the institutions that will be paid off with the $1 billion loan aren't in the United States, the Federal Reserve's own review of the Hunt loan discloses. According to the Fed, here is how the Hunts plan to use the money:

- $260 million to pay debts of International Metals Investment Corp. (IMIC), a Bermuda company controlled jointly by the Hunts and several Saudi Arabian investors.
- $175 million to repay "U.S. branches and agencies of foreign banks" for loans they made directly to the Hunts.
- $160 million to repay foreign banks for money loaned indirectly to the Hunts through commodity brokers. The foreign banks loaned the money to the brokers, who reloaned it to the Hunts.
- $120 million to the Hunt family-owned Placid Oil Co. to repay Placid for money it already has used to pay Hunt debts to foreign banks.
- $200 million to repay Placid for money it has used to pay Hunt debts to U.S. banks.
- $85 million to repay directly U.S. banks for loans to the Hunts.

Only the last two items will go directly to pay the Hunts' debts to U.S. banks, and they account for less than one-third of the billion.

Part of the $260 million to be used to pay obligations of the Bermuda company, IMIC, also may flow to American companies, but how much couldn't be determined from the Federal Reserve report.

CFTC investigators have determined that IMIC is owned jointly by Nelson Bunker and W. Herbert Hunt, a corporation controlled by Hunt family trusts, and two Saudi Arabians.

Hunts' Silver Loans to Go Mainly to Foreign Debt

SILVER, From D7

to pay personally IMIC's debts to U.S. banks and brokerage houses.

CFTC officials say those debts appear to be substantially less than the Federal Reserve has reported. The Federal Reserve report is based on communications with the Hunts and their banks but auditors from the commodity agency have had access to the books of the companies the Hunts did business with.

IMIC is believed to have suffered heavy losses on silver speculation outside the United States, but federal investigators have no way to find out about that.

As the Federal Reserve acknowledged in its report to Proxmire, "because of the many entities involved—including foreign entities—and the complexity of the transactions, all of the facts of the case may never be known with precision."

Nor have federal authorities been able to find out the names of the foreign banks to whom the Hunts owe money.

Two foreign banks have been identified among groups of lenders who loaned money to the Hunts' principal silver broker, the Bache Group Inc. and its subsidiaries.

Bache borrowed $4 million from the Royal Bank of Canada and $4.8 million from Barclay's Bank of England, according to CFTC records.

When they testified before a congressional committee last month, Bunker and Herbert Hunt listed one other foreign lender: Swiss Bank Corp., among their creditors.

The Hunts are expected to face new questioning about their foreign debts when they return to Washington on Thursday to testify before Proxmire's committee.

Hearings on silver also are being held this week by a Senate agriculture subcommittee chaired by Sen. Donald Stewart (D-Ala.).

The Hunts' silver-speculation debts totaled $1.765 billion as of March 31, the peak of their borrowings, according to the Federal Reserve.

The Hunts borrowed from 12 U.S. banks, one foreign bank and the U.S. branches or agencies of four other foreign banks, the agency said.

The Federal Reserve estimates that somewhat less than half those debts have been repaid so far, mostly by selling the Hunts' silver.

The remaining debts will be "restructured" through a complex arrangement involving Nelson Bunker and Herbert Hunt, another brother Lamar and Placid Oil, which is owned by the Hunt family trusts.

The banks will loan the $1 billion or thereabouts to Placid and will get mortgages on not only Placid's properties but virtually everything else owned by the three brothers.

Wednesday, May 28, 1980

Placid Borrows $1 Billion To Pay Off Hunts' Debts

By KAREN W. ARENSON

Thirteen major banks turned over almost $1 billion to the Placid Oil Company yesterday so that Placid could pay off debts incurred by members of the Hunt family, according to a spokesman for the Morgan Guaranty Trust Company.

It could not be learned from Placid yesterday which of the Hunts' loans it planned to pay off or how quickly.

The Placid borrowing was made possible by the signing of a $1.1 billion credit agreement yesterday between Placid and the 13 banks, headed by Morgan Guaranty and the First National Bank of Dallas. The loan agreement had been under negotiation for almost two months.

Of the $1.1 billion, $350 million will go to refinancing loans already made to Placid by some of the banks in the group.

An important difficulty in the negotiations was the banks' insistence on as much collateral as possible for the loan. Earlier, Placid had pledged most of its large oil and gas properties to secure its bank borrowings.

But since Placid is held in six different trusts for the benefit of various Hunt family members, the banks were reportedly concerned that they might have problems collecting quickly if the company defaulted on the loan. So Nelson Bunker Hunt, William Herbert Hunt and Lamar Hunt also had to pledge virtually everything they owned — ranging from race horses to art to agricultural properties — to help secure the Placid loan.

The $1.1 billion credit agreement

Continued on Page D7

Placid Borrows a Billion for Hunt Debt

Continued From Page D1

signed yesterday must be repaid by 1990. Morgan Guaranty would not disclose the interest rate, nor would it comment on the Hunts' statement to a Congressional subcommittee two weeks ago that the rate would be 1½ to 2 points above the prime rate.

In addition to the two lead banks, other institutions participating in the loan are the Bank of America, the Bankers Trust Company, the Canadian Imperial Bank of Commerce, the Chase Manhattan Bank, the Chemical Bank and Citibank. Also involved are Continental Illinois, the First National Bank of Chicago, the Manufacturers Hanover Trust Company, the Republic National Bank of Dallas and the Royal Bank of Canada.

Although the Hunt brothers owned millions of ounces of silver, they had contracted for future purchases of millions more at set prices. They had also borrowed against the silver they owned.

As the price of silver tumbled from more than $50 an ounce in January to $10.80 an ounce in late March, the Hunt losses mushroomed, and the brothers were forced to borrow more and more money to pay off their debts. According to a report by the Federal Reserve Board, loans to the Hunts and the Hunt interests amounted to $1.8 billion by early April. The Fed report said that approximately $800 million of that debt still remained.

The Hunts declined to be interviewed yesterday and their attorneys did not return repeated telephone calls.

Placid agreed to set up a partnership with the Hunts that would repay their debts. Sources close to the situation said that Placid had become involved when it became clear that any bankruptcy action filed by the Hunts would result in Placid's being dragged into court as well.

As the Hunts and their attorneys described the partnership arrangement to two Congressional subcommittees earlier this month, Placid would contribute cash (raised through the $1.1 billion credit agreement) and the brothers would contribute large portions of their assets, including 63 million ounces of silver, even though most of the assets had already been pledged to secure their own borrowings. The Hunts put the equity value of the assets was about $453 million.

The idea was that the partnership would sell the Hunts' assets to repay their loans, but that by spreading it out over a period of years, instead of all at once, better prices could be realized.

To the extent that these assets are sufficient to pay off the debts, all of the other assets that the Hunts have pledged as security to the banks would return to the Hunts' control.

The Hunts have already transferred some of their properties to Placid. Nelson Bunker Hunt moved 29 parcels of property in Anchorage to Placid last week. And William Herbert Hunt filed documents transferring his 40 percent share of leases on 20,640 acres in the coal-rich Beluga area 30 miles west of Anchorage.

Separately, the Engelhard Minerals and Chemicals Corporation said yesterday that the Canadian Foreign Investment Review Agency had said it would not review the Hunts' transfer of interests in certain oil and gas properties in the Beaufort Sea to Engelhard, thereby essentially clearing the deal. The Hunts had given Engelhard those properties, as well as 27.5 million ounces of silver. Engelhard, in turn, let them out of a contract to purchase some 19 million ounces of silver that would have involved a loss to the Hunts of almost $400 million.

Placid Oil Paying Off Hunt Debts

THE NEW YORK TIMES, THURSDAY, MAY 29, 1980

By KAREN W. ARENSON

Placid Oil has started to pay off the Hunt Brothers' remaining silver debts — estimated by the Federal Reserve Board at about $860 million — and expects to finish the task in "a matter of weeks," according to C.D. Brown, president of Placid Oil.

"The loans are being paid off," Mr. Brown said in a telephone interview yesterday. "They are in the process of being paid. The whole set is being paid immediately."

The payments appear to eliminate whatever concern remained that the financial empire of Nelson Bunker Hunt and W. Herbert Hunt might topple because the brothers could not meet the debts resulting from the sharp drop in silver prices in late March.

Several Congressional subcommittees are now studying the need for legislation to prevent a repeat of the Hunt episode. Disclosures in late March that the Hunts did not have the cash to cover losses resulting from their millions of dollars in silver trading threw financial markets into temporary chaos and created concerns over the health of some brokerage firms and banks.

Company Strong Credit Risk

Although Placid Oil, which is held in trust for members of the Hunt family, has now assumed almost $1 billion in debt to pay off the Hunt brothers' loans, the company is regarded as a strong credit risk. Furthermore, bankers say, the collateral backing the loan is more-than-sufficient security. Placid's own oil holdings serve as collateral. In addition, the Hunt brothers have pledged as security most of their personal assets.

Placid Oil received almost $1 billion on Tuesday to enable it to begin the repayment process, after finally signing a 10-year credit agreement for $1.1 billion with a consortium of 13 major banks. The money is being transferred into a partnership between Placid and the Hunt brothers that will pay off their debts and then gradually sell off Hunt assets to repay the $1.1 billion credit.

Mr. Brown said yesterday that management and disposal of the partnership's assets would be handled by Placid Investments Ltd., a subsidiary of Placid Oil.

Asked whether the Hunt brothers would have any say — direct or indirect — in how the partnership assets were disposed of, Mr. Brown responded with an emphatic "No." These assets include silver bullion estimated at 50 million to 63 million ounces, securities, and coal lands worth $204 million.

Placid is clearly moving quickly to pay off the additional Hunt debts that the $1.1 billion consortium loan is refinancing.

One large lender to the Hunts said yesterday that it had been repaid on Tuesday.

There has never been a complete listing of all of the Hunts' creditors. In hearings before two Congressional subcommittees earlier this month, the Hunts said they had debts outstanding to at least two brokerage firms, Merrill Lynch & Company and ACLI, and to at least two banks, Citibank and the Swiss Bancorp.

Last Friday, the Federal Reserve Board said that the amounts owed by the Hunts and their related interests totaled $1.7 billion at their peak, but that only $860 million in debts still remained. Although the Fed did not name specific lenders, it provided the following breakdown of the $860 million in debt that remained:

¶Direct loans by United States banks to the Hunts of $35 million.

¶Loans to the Hunts by United States branches and agencies of foreign banks of $175 million.

¶Obligations to brokerage firms by the Hunts and IMIC (an offshore corporation that the Hunts owned jointly with several wealthy Saudi investors) of $280 million.

¶Loans to the Hunts by brokerage firms that had borrowed from banks of $100 million.

The Fed also listed advances by Placid Oil to the Hunts to meet some of their other debts of $410 million.

Hunts Can Hold, Buy Silver

By Jerry Knight
Washington Post Staff Writer

The Hunts of Texas will be able to hold on to their vast hoard of silver and buy still more under terms of the $1 billion bail-out loan package they have negotiated with a group of the nation's biggest banks, it was disclosed in congressional hearings yesterday.

Part of the loan money will be used to buy silver under a contract the Hunts signed some time ago, Federal Reserve Board Chairman Paul A. Volcker told the Senate Banking Committee.

Since last June, the Hunts have purchased at least 106 million ounces of silver, it was revealed in a Commodity Futures Trading Commission report made public by Sen. Donald L. Stewart (D-Ala.).

The report is the first accounting of how much silver the Hunts collected in their silver-buying spree. It includes only their purchases on the U.S. futures market, and does not count silver bought overseas.

Under questioning by Stewart, Volcker admitted for the first time that the Hunts will be able to make at least one more purchase of silver using money from their controversial loan.

Volcker said the loan permits the Hunts to make good on a "forward contract" they signed to buy silver. He did not say how much silver the contract will give to the Hunts.

Volcker assured the banking committee that the loan agreement will prevent the Hunts from continuing to speculate in silver and will require them to sell off present holdings.

Volcker's testimony appeared to conflict with what Hunt attorney Roger Goldburg told reporters after Nelson Bunker and W. Herbert Hunt appeared before a House Agriculture subcommittee.

Goldburg said the silver the Hunts already own "would be treated as an investment and dealt with in an orderly fashion." He said there is "no time limit to liquidate silver" in the loan agreement signed with a group of major banks.

The loan requires silver speculators Bunker and Herbert Hunt and their brother Lamar to transfer all their assets to a new partnership formed with Placid Oil Company. Placid is owned by Hunt family trusts.

Placid will also take over the Hunts' [illegible] escalating debts and pay them off with the billion dollars borrowed from the banks.

Representatives of First National Bank in Dallas and Morgan Guaranty Trust Co. of New York, the two lead banks on the loan, are scheduled to testify today before the Senate Banking Committee, chaired by Sen. William Proxmire (D-Wis.).

At hearings yesterday before the House Agriculture subcommittee chaired by Rep. Ed Jones (D-Tenn.), Bunker and Herbert Hunt charged they were the victims, not the cause, of silver market manipulation.

The Hunts accused the directors of the nation's two major silver markets, the Chicago Board of Trade and New York's Commodity Exchange Inc., of changing their rules to benefit some exchange members.

Bunker Hunt called it "a classic case of market manipulation."

When silver prices began climbing rapidly [illegible] the two exchanges, at the urging of federal commodity regulators, imposed new rules to discourage speculation. They raised the amount the deposit speculators must put up to purchase contracts for future delivery of silver, and also put limits on the number of contracts any individual could buy.

Herbert (left) and Nelson Bunker Hunt testifying before a House Agriculture subcommittee; said the [illegible]

Hunts Can Keep Their Silver

SILVER, From D1

The Hunts insisted the actions were taken to benefit exchange members who wanted silver prices to go down.

Asked about assurances that exchange members with a financial stake in silver had abstained from voting on the rules changes, Bunker Hunt replied, "they may have abstained, but it's a very small club."

Subcommittee Chairman Jones said later his panel will ask the two silver exchanges for information about the silver holdings of their directors and the part silver speculators played in the decision making.

The Hunt brothers agreed to give Jones' subcommittee detailed reports showing how many silver futures contracts they owned and how much silver bullion they bought for each of the last eight years.

The CFTC report prepared for Stewart showed that the two brothers and a company they control have taken delivery of 21,284 contracts since last June.

Each contract is for 5,000 ounces. The 106 million ounces of silver would be worth almost $1.4 billion at current prices of about $13 an ounce.

Meanwhile, the Illinois attorney general has accused the Hunts of swindling investors out of millions of dollars in a land-investment scheme, news services reported.

Attorney General William J. Scott sued the Hunts for damages yesterday in Circuit Court, saying that about 1,000 Illinois citizens were victimized by the Cochiti Lakes land development 25 miles south of Santa Fe, N.M. A spokesman for Scott said about 5,000 people elsewhere in the nation also were swindled.

Scott said the court ultimately will determine the amount of damages to Illinois investors but that it would amount to "at least $20 million."

Friday, May 30, 1980

THE NEW YORK TIMES, FRIDAY, MAY 30, 1980

Hunts Said to Face No Silver Deadline

Total Put at 60 Million Ounces

By KAREN W. ARENSON

Special to The New York Times

WASHINGTON, May 29 — In testimony before a House agriculture subcommittee, Nelson Bunker Hunt and W. Herbert Hunt raised the possibility today that their large inventories of silver might not have to be totally sold to satisfy their $900 million in debts.

They told the subcommittee that there was no stipulation anywhere that the silver be sold by any particular deadline. They also said that all the silver and silver futures contracts they currently owned were being transferred to a partnership between them and the Placid Oil Company, which has been set up to dispose of their debts by selling off some of their assets.

Herbert Hunt estimated after the hearings that the silver and silver contracts still owned by the brothers and their various interests amounted to about 60 million ounces. Although the brothers have already promised two other Congressional subcommittees that they will provide a full accounting of their silver transactions, neither panel has yet received any accounting from the Hunts.

However, a Senate agriculture subcommittee headed by Senator Donald W. Stewart, Democrat of Alabama, disclosed that the Hunts had purchased 106 million ounces of silver between June 1979 and March 1980.

According to the figures, which were compiled by the Commodity Futures Trading Commission, Bunker Hunt bought 42.6 million ounces, Herbert Hunt purchased 23.7 million ounces, and IMIC, a Bermuda-based company they owned jointly with some Saudi Arabian investors, bought 40.6 million ounces. The Hunts are believed to have taken over IMIC's assets and debts.

Some of that silver has since been sold off to satisfy their debts to various brokerage firms and banks. It is not known how many ounces of silver they held prior to last June.

The Hunts, who have been buying silver since 1973, said yesterday that they had been forced to sell off their silver positions by unfair actions of the commodity exchanges, whose directors were acting in their own self-interest.

"It was a classic case of market manipulation by the shorts," said Bunker Hunt in his brief opening statement to the House subcommittee, which was the most sympathetic Congressional forum they have encountered.

Asked whether the exchanges' actions were illegal, Herbert Hunt responded: "Yes, I consider them illegal." But he said that he had not yet decided whether to sue the exchanges.

Separately, the Senate Banking Committee, headed by Senator William Proxmire, Democrat of Wisconsin, held hearings on the Senator's proposed legislation to increase the regulation of the commodity markets. Senator Proxmire received only limited endorsement, however, from the panel of Government officials who testified.

They included Paul A. Volcker, chairman of the Federal Reserve Board; Harold M. Williams, chairman of the Securities and Exchange Commission; Robert Carswell, Deputy Treasury Secretary; John G. Heimann, Comptroller of the Currency, and all four commissioners of the Commodity Futures Trading Commission.

Senator Proxmire has proposed that the Fed be given broad authority over regulating the financial portions of the commodity futures markets. Mr. Volcker said, however, that the Fed was reluctant to endorse any specific regulatory approach until it completed a study — along with several other agencies — of the issues.

"I must confess to a sense of uneasiness arising from the potential complexities of effective regulation of these markets, with all of its implications for staffing requirements and for demands on the time and energy of the board," he told the committee.

Mr. Heimann also called for further study before any action was taken, although he said that "both Congressional and regulatory action is warranted."

Hunts Sued on Land Deal

CHICAGO, May 29 (UPI) — The Illinois Attorney General said today that he had filed a lawsuit against Nelson Bunker Hunt, W. Herbert Hunt and others over an allegedly fraudulent land development program.

Attorney General William J. Scott said 1,800 Illinois residents were "victimized" in a New Mexico land development. He added that damages could amount to $20 million nationwide and asked that money be refunded to purchasers.

"They were promised improvements, recreational facilities and substantial investment profit," Mr. Scott said at a news conference. "None of the promises" was fulfilled, he added.

8 THE WALL STREET JOURNAL
Monday, June 2, 1980

Senate Panel Is Told Bache Misled Bank Over $75 Million Loan for Silver Trading

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON—First National Bank of Chicago was misled about a $75 million loan the bank extended to Bache Group Inc. just before the March silver market crash, the bank's president said.

Testifying on the bank's role in financing the silver-trading Hunt brothers and their broker, Bache, bank president Richard Thomas told the Senate Banking Committee the bank had been advised the silver Bache had pledged as collateral was hedged, or protected against a drop in silver prices.

But when the bottom fell out of the silver market late in March, the bank discovered that the silver collateral wasn't hedged, Mr. Thomas said. The loan became "undercollateralized . . . in a very short period" as silver prices plummeted and the value of the collateral dropped. Bache repaid the loan in full, Mr. Thomas said, by selling much of its silver holdings.

"There was certainly a misunderstanding (between Bache and the bank) as to the terms of that particular loan," Mr. Thomas told the committee, which is looking into the silver market crash. After the hearing, however, he declined to say whether he felt Bache had violated written terms of the loan agreement, or whether the misunderstanding had been simply oral. During the hearing, he added that the bank wouldn't have lent Bache as much money as it did if it had known the collateral wasn't properly hedged.

Mr. Thomas testified along with Elvis Mason, chairman of First National Bank of Dallas, and James O. Boisi, vice chairman of Morgan Guaranty Trust Co. of New York. As expected, all three defended the $1.1 billion line of credit being extended by a group of 13 banks to refinance the silver debts of the three Hunt brothers, Nelson Bunker, W. Herbert and Lamar.

Mr. Mason said he initiated discussions about the credit line after assessing the impact of the slide in silver prices on the Hunts and finding a "very unfortunate and serious situation over which we developed great concern." He added that "it was apparent that some action should be taken to avoid further problems in the financial and credit markets in general."

All three bankers argued that the $1.1 billion credit line isn't new speculative financing or a bailout of the Hunts, as several committee members repeatedly called it. "Rather," Mr. Mason said, "it brings stability to what at best was a most uncertain outcome of a serious problem."

The committee has been investigating whether the refinancing loan violates a request by Federal Reserve Chairman Paul Volcker in October that all banks operating in the U.S. avoid lending for speculative purposes.

Messrs. Mason, Thomas and Boisi all said that since October their banks haven't made any loans to the Hunts for silver speculation. Mr. Thomas acknowledged, however, that First National Bank of Chicago made a $50 million loan to Lamar Hunt in late February that was partially secured by silver. But he said the purpose of this loan was to "meet margin calls and facilitate the orderly liquidation of his silver positions," and as such wasn't speculative.

The committee's chairman, Sen. William Proxmire (D., Wis.), criticized board members of the nation's largest silver mart for what he called an apparent conflict of interest between their personal silver investments and their duties as market regulators.

Sen. Proxmire said that on Jan. 17 nine of the 23 Commodities Exchange board members had net "short" silver futures positions of 7,700 contracts, obliging them to deliver at a future date 38 million ounces of silver valued at $1.96 billion. Echoing charges made by the Hunt brothers and other traders, Sen. Proxmire said these "incredibly large short positions" give "the appearance of substantial self-interest" by the board members when they moved in January to restrict silver trading. If the board hadn't acted then, silver prices might have kept rising, increasing the losses of anyone holding "short" contracts.

But Comex President Lee Berendt, a witness at the hearing, denied any conflict. He said all nine board members had their futures positions fully hedged, or protected against loss, in the spot silver market.

Hunt Firm Wins Land Case

By a WALL STREET JOURNAL *Staff Reporter*

ALBUQUERQUE, N.M.—Interests controlled by the Hunt brothers won a case in federal court involving a land development near here.

The jury found for the defendants in all but one of the charges brought by 45 Cochiti Lake landowners claiming the developers hadn't fulfilled their promises. The suit sought $500,000 in damages from Great Western Cities Inc., a unit of Great Western United Corp., both of which are part of Hunt International Resources Inc.

In the one award, a woman was given about $2,000 because the lot she bought wasn't what she thought it would be, an attorney for the companies said. Attorneys for the other side weren't available for comment.

Another case is pending with similar charges. A similar one was won earlier by the defendants.

The same land development was named in a land fraud suit filed by the attorney general's office in Illinois last week.

Fed statements on Hunts prove wrong

JUN 19 1980

By CRAIG FLOURNOY

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The Federal Reserve Board and its chairman, Paul Volcker, were wrong when they said banks did not make major loans to finance the Hunt brothers' massive silver holdings last year, documents obtained by *The Dallas Morning News* show.

To maintain and expand their silver purchases, Nelson Bunker Hunt, W. Herbert Hunt and a Bermuda-based company they control borrowed more than $425 million from banks and brokerage firms by Jan. 1, 1980 — 10 days before silver futures prices peaked at about $50 an ounce — documents submitted by Hunt attorneys to a congressional panel indicate.

The "silver-related" bank loans, almost all of which were collateralized by silver, occurred after Volcker twice asked the nation's banks in October 1979 not to make loans for speculative purposes. He said the banks' cooperation would help curb the country's inflation rate.

Frank O'Brien, special assistant to the Federal Reserve Board, said Wednesday concerning the discrepancy: "We didn't try to mislead congress on this point. We told them in good faith what we knew at that time.

"I'm not saying it (the original report) is the biblical truth."

The latest revelation is expected to fuel new questions by already angry congressional officials probing loans made to finance the Hunts' silver dealings. In a letter to Volcker made public Wednesday, Rep. Henry Reuss, D-Wis., takes the Fed to task for its "plainly inadequate" work in monitoring the silver situation and asks Volcker for a full accounting of why he and his agency allowed several banks to lend the Hunts millions of dollars while "productive" businessmen were "being severely squeezed."

In another development, it was learned that Placid Oil Co., owned by Hunt family trusts, secured a $450 million loan agreement with First National Bank in Dallas and 10 other banks on Nov. 30, 1979, long before silver prices dropped, other documents indicate.

By March 26 of this year, Placid had loaned the two Hunt brothers more than $100 million to cover their losses in the silver market, documents show. The loans were made long before the Hunts

See AGREEMENT on Page 7A

Thursday, June 19, 1980 The Dallas Morning News 7A

Agreement puts Hunt partnership in question

Continued from Page 1A.

worked out their formal loan partnership with Placid.

Congressional sources said such a large line of bank credit to Placid in Nov., 1979 suggests the company was preparing to make big loans to the Hunts to maintain their massive silver positions.

"Why did Placid Oil, when oil prices were going up and all the oil companies were raking in the bucks, need $400 million?" asked an aide to one congressional panel investigating the Hunts' silver dealings. "Was Placid running out of cash?

"It's all really weird."

Revelation of the 1979 loan agreement with Placid throws into question the partnership recently formed between a Placid subsidiary and the Hunts to pay off the brothers' $1 billion in silver debts. The interim Fed report on the silver crash and the loan to cover the Hunts' debts states that the Hunts are to "exercise no control or influence over the partnership."

The News revealed recently, however, that Placid's ability to pay off the $1 billion loan is riding on a host of the Hunt's debt-ridden assets contributed to the partnership, while most of the Hunts' personal, debt-free holdings — which cannot be touched by Placid — have been kept outside the partnership.

Telephone calls made to Hunt attorneys by The News to discuss the Hunts' silver loans were not returned.

Documents submitted to the House Government Operations Subcommittee on Commerce, Consumer and Monetary Affairs by the Hunts' Dallas law firm shed the strongest light yet on the Hunts' silver purchases — and the massive loans needed to maintain their huge position in the market.

These documents show the Hunts received large injections of funds as early as August 1, 1979, though this was months before the price of silver fell.

This information contradicts an interim report by the Fed released on May 26 which declared bank credit was not a major factor in the Hunts' maintaining their silver positions.

As Fed chairman Volcker said in a letter accompanying the report, "One of the major conclusions of our investigation to date is that we can find no evidence to suggest that bank credit was used in a significant way by the Hunt interests to finance the acquisition and maintenance of their massive silver position during the period in which silver prices were rising."

Documents submitted by the Hunt attorneys tell a different story.

By Aug. 1, the Hunts and a foreign-based company they own at least half of, International Metals Investment Co., Ltd., had borrowed about $200 million to cover what are labeled as "silver related liabilities," documents show. More than $110 million of these loans were extended to the Hunts directly by banks.

The Hunts used silver as collateral for most of the loans, a situation that has been criticized by some congressional officials because of the volatile rises and falls in the metal's price.

Since silver prices had risen steadily since the beginning of 1979, a trend which benefited the Hunts' "long" position in the market, evidence uncovered by federal agencies suggests the Hunts also were using at least part of this money to finance new positions in the silver futures market.

IMIC, which the Hunts and two Saudi Arabian silver speculators own, began buying silver futures in July, 1979. By the end of August, IMIC held the rights to 42 million ounces of silver, according to a report by the Commodity Futures Trading Commission.

As silver futures prices began a dramatic rise in August, 1979, the directors who regulate the exchanges where the Hunts traded silver futures began raising the margin levels ("good faith" money an investor must put up initially) on each contract.

As early as Sept. 6, 1979, for example, the New York-based Commodity Exchange Inc. increased the original margin on silver from $1,500 per contract to $2,000 per contract. On Oct. 22, COMEX adopted an emergency rule requiring an original margin of $60,000 on all silver contracts involving speculators.

With the Hunts holding massive positions in the silver market, and IMIC increasing its holdings, all were faced with huge expenses to maintain their holdings.

By Jan. 1, 1980, the Hunts and IMIC had more than $425 million in "silver related liabilities," documents indicate. Bermuda-based IMIC alone owed banks almost $200 million, documents indicate.

Huge loans also were being made by brokerage houses to finance the silver dealings of the Hunts and IMIC. Many of these loans apparently originated with banks.

For example, Richard Thomas, president of the First National Bank in Chicago, has testified before the Senate Banking Committee that his bank loaned a subsidiary of Bache Halsey $75 million beginning in late Fall, 1979, money which later went to finance the Hunts' silver dealings.

By the time silver prices crashed to less than $11 an ounce on March 27, the Hunts and IMIC owed more than $1.75 billion in silver-related debts with more than a half-billion dollars owed directly to banks, documents indicate.

First National Bank in Dallas had loaned out $30 million of that total, including $15 million to Nelson Hunt, $13 million to IMIC and $2 million to Herbert Hunt.

These loans, like those made by other banks prior to the drop in silver prices, also would violate the spirit of the Fed's requests in October and March that banks refrain from making speculative loans.

Goldfield Agrees to Sell Stake in Silver Project To Hunt's Daughter

By a WALL STREET JOURNAL *Staff Reporter*

MELBOURNE, Fla. – Goldfield Corp., which a few weeks ago revised a silver project agreement with financially strapped Nelson Bunker Hunt, agreed instead to sell a stake in the project to Ellen Hunt Flowers, Mr. Hunt's daughter.

In Dallas, Thomas Whitaker, spokesman for Hunt Energy Corp., said Mr. Hunt was "personally committed to proceeding with the transaction" but a prohibition under the Hunts' $1.1 billion loan agreement precluded him from "personally proceeding with the transaction."

Under the $1.1 billion credit line, designed to refinance the Hunts' silver debts, the Hunts have been barred by a group of 13 banks from any commodity and stock speculation until the loan is paid off.

Last February, Mr. Hunt agreed to buy a 20% stake of Goldfield's silver exploration project in Sierra County, N.M., for $2 million. Earlier this month, Mr. Hunt agreed to buy only 4%, plus an option to buy another 16%.

Under the agreement, Mrs. Flowers bought a 4% stake in the project for $400,000 and acquired an option for an additional 16%, exercisable within one year, for $1.6 million. Mr. Whitaker said she used personal funds in the purchase. Subject to the exercise of the first option, Mrs. Flowers will also have an option to buy an additional 30% within four years.

James Sottile III, Goldfield's president, was on his way back from Dallas, where he signed the agreement with Mr. Hunt, and couldn't be reached for comment.

June 25, 1980

THE WASHINGTON POST Wednesday, August 13, 1980

Hunt Filing to SEC Raises Questions on Conflict of Interest

By Jerry Knight
Washington Post Staff Writer

Texas billionaire Nelson Bunker Hunt, already under investigation by the Securities and Exchange Commission, yesterday filed a report with the agency which raised new questions about conflicts of interest between the Hunts and the Bache Group Inc., the brokerage house that handled most of the Hunts' silver business.

The report showed Bunker Hunt and his brother, W. Herbert, bought stock in Bache at "the suggestion and request" of Bache officials, placed the orders for Bache stock through Bache brokers and borrowed money from Bache to pay for the stock, putting up Bache shares as collateral for the loan from Bache.

In the filing, Bunker Hunt also acknowledged that he might have violated securities law by not publicly disclosing his purchases of Bache stock.

The law requires any individual or group that buys more than 5 percent of a public corporation to report the purchase to the SEC. In the document filed yesterday, Bunker Hunt said he and his brother Herbert each own 3.3 percent of the shares of Bache, a total of 6.6 percent.

The brothers' holdings have totaled more than 5 percent since Jan. 16., the report said. The law requires disclosure of the purchases within 10 days after the 5 percent threshold is reached.

The Bache shares were purchased through an account owned jointly by Bunker and Herbert Hunt, but Bunker denied he and his brother were buying the stock together.

"Notwithstanding the express terms of the joint account agreement, it was understood between N.B. Hunt and W.H. Hunt that one-half of each purchase in the joint account was owned by N.B. Hunt and one half was separately owned by W.H. Hunt," the SEC filing stated.

The report said Bunker "does not concede" that he violated the law. "On the other hand, he recognizes that in this area of the law different parties may interpret the relevant facts as calling for different legal conclusions."

The Hunts already have lost one fight with federal regulators over whether family members were acting as a group when several of them made the same investment. The Commodity Futures Trading Commission cited Bunker, Herbert and several other family members for violating federal limits on investments in commodities, after the Hunts allegedly tried to corner the market in soybeans.

The Hunts claimed they were buying soybeans independently because they all thought beans were a good investment, but the federal courts upheld the CFTC's contention they were buying together and therefore breaking the law.

By filing the SEC report now—almost seven months after the stock was purchased—Hunt could seek to minimize any disciplinary action by the SEC. It's better to file the report late than not at all, agency officials said, but they refused to confirm or deny that Bunker Hunt's report was filed under pressure. Herbert Hunt has made no report to the SEC.

The Hunts' purchases of Bache stock were reported to the SEC and the New York Stock Exchange by Bache last March, shortly after the price of silver plunged from $50 an ounce to $23, causing a financial crisis for both the Hunts and Bache.

The Hunts had been buying silver on credit through Bache for months and when prices collapsed were unable to pay their debts. Trading in Bache stock was halted for a few days when it appeared the company might be forced into bankruptcy if the Hunts did not find funds to repay Bache. The Hunts

See SILVER, D9, Col. 1.

Hunt SEC Filing Raises Questions

SILVER, From D6

eventually repaid all their silver debts, aided by a $1.4 billion loan from a group of banks.

The documents filed by the Hunts suggest that Bache may have warned the Hunts as long ago as February that the joint purchases might violate SEC laws. On Feb. 20, the Hunts wrote a letter to a Bache executive vice president, Charles Mattey, telling him to split the brothers' holdings into separate accounts. The letter said the order was "in reference to our recent telephone conversation relative to the joint account."

Bunker Hunt told the SEC he and his brother began buying Bache stock last October, "following the suggestion and request of management of Bache." At that time, members of the Belzberg family of Canada also were buying stock in Bache, and corporate officials feared the Belzbergs might try to buy control of Bache.

The first 50,000 of the 576,000 shares were purchased on margin, with Bache lending the Hunts half of the money for the stock and holding the shares as collateral, the report shows.

The Hunts also used Bache stock as collateral on the loans from Bache to buy silver.

Bache's decision to take its own stock as collateral for a loan is one of the issues under investigation by the SEC. Normally, a stockbroker can simply sell stock put up as collateral if the customer cannot pay off the loan. But to sell shares of its own stock, Bache would have had to file an elaborate offering statement with the SEC.

Staff writer James L. Rowe Jr. also contributed to this story.

3. CASH MARKET EFFECTS

Banking Regulators Acting To Curb Futures Speculation

By Jonathan Fuerbringer
Washington Star Staff Writer

Government banking regulators are drafting a new policy that would curb speculation by banks in the futures market and other financial contracts susceptible to quick fluctuations in value.

The new policy, which is expected to be voted on soon, is aimed at protecting banks from significant losses in markets where it only takes a small amount of money up front to be exposed to the potential of very large losses.

In a draft policy statement obtained by The Star, it is acknowledged that some financial institutions recently "have been exposed to potentially large losses that could (and sometimes did) significantly affect their financial condition."

One of the key elements of the draft policy, according to government sources, is a change in crediting of fees earned on some contracts, which will make the contracts less attractive.

These fees, despite the risk of the commitment and, therefore, the potential loss, had been sought as a way to generate "immediate income," sources said.

The policy statement also requires board-of-directors approval of investment practices and specific accounting and reporting procedures. In addition, the policy holds out the threat of limiting bank involvement in these markets. Trading in long-term (more than 150-day) standby contracts is also prohibited.

A recent U.S. Treasury study said the solvency of some banks was threatened by trading in Government National Mortgage Association (Ginnie Mae) securities and that the "proximate cause" for failure of a subsidary of a foreign bank was trading in futures.

The risk has been accentuated by the Federal Reserve's credit-tightening policy, which has made interest rates volatile, and in turn, increased the potential for loss because values are tied to interest rates.

This credit-tightening has especially affected the market for Ginnie Mae securities, which are backed by mortgages purchased by the government, and sparked rumors of significant losses because of overcommitments and the unexpected climb in interest rates, which has cut the value of the securities.

The draft policy is subject to revision and must be approved by the Federal Reserve Board, the Federal Deposit Insurance Corp. and the Comptroller of the Currency.

Until development of this policy, only the comptroller — the regulator of national banks — had restrictions on futures and other contracts, which left most state-chartered banks covered by FDIC insurance without any policy.

Futures are contracts to buy or sell a specific commodity at a future date at a price set by trading on commodity exchanges. Futures contracts on commodities and financial instruments, including contracts on Treasury bills, are regulated by the Commodity Futures Trading Commission and the individual exchanges on which the contracts are traded. It is the financial futures that the policy is aimed at.

The other area to be covered by the policy is forward and standby contracts for government securities, especially Ginnie Mae securities. This trading is unregulated.

A forward delivery contract is an agreement to buy or sell the securities at a date in the future at a set price. A standby contract is an option on future purchase or delivery. For a fee, a bank can agree to purchase securities at a set price in the future.

The draft policy bans involvement in standby contracts of 150 days or more because, it says, regulators found the commitments were made only for fees or to speculate on interest rates.

STAR NOV 6, 1979

METALS

Precious metals put users in a cost bind

Big industrial users of precious metals, pummeled by spiraling prices for gold, silver, and platinum, are girding for an even more severe trouncing in the coming months. After three quarters of steadily increasing costs, companies that use the metals for products, from silver-coated photographic and X-ray film to gold-plated electronic contacts, are expecting a squeeze on margins and, in some cases, on 1979 earnings. Near-term, most see no stabilization in the precious metals markets, because of events in Iran and the oil-producing nations as well as speculative fever by investors worldwide.

To cope with their rising costs, precious metals users who have restrained prices to comply with federal guidelines have in recent months aggressively increased their prices. Although the properties of precious metals are almost impossible to duplicate in many industrial applications, companies such as Eastman Kodak, Western Electric, International Rectifier, and National Semiconductor's Dynacraft subsidiary are accelerating research on possible substitutes. Already, in the third quarter, industrial usage of gold dipped some 14%, while silver consumption fell 13%. The cost increases are "hitting all levels of the precious metals industry," says Walter L. Frankland Jr., executive vice-president of the Silver Users Assn.

Kodak's wounds. Hardest hit are high-volume silver users. Eastman Kodak Co., for example, uses some 50 million oz. of silver annually, and, according to Kodak President Colby H. Chandler, every time the price goes up $1 per oz. it adds some $50 million to Kodak's operating costs. Kodak's average cost of silver has jumped from $5.24 per oz. a year ago to nearly $14 per oz. in September, and Wall Street analysts predict that the company's average silver costs will be nearly $17 per oz. for the fourth quarter. "Kodak's earnings [for 1979] would have been up modestly were it not for silver," says Richard D. Schwarz, analyst with L. F. Rothschild, Unterberg, Towbin. "It's the fourth quarter that's going to feel the whammy from silver prices."

Like other users, Kodak is scrambling to conserve and recycle metal. Last year the company recovered $125 million worth of silver from its film-producing operations, and it hopes to increase its recovery values. Kodak has also increased prices 6% to 15% in the last two months on photographic film, and by as much as 25% on X-ray film.

Although smaller volumes of gold are used in industry, price increases have forced some major design changes. "Up to now, when gold prices surged, we figured they'd come down," says H. William Collins, vice-president for advanced products at International Rectifier Corp., a maker of semiconductor products. "But the pattern is clear now," says Collins. "We've decided to design gold out." National Semiconductor's Dynacraft subsidiary still uses gold and silver in its electrical components, but, says President Robert M. Allen, "one of my goals is to eliminate precious metals." Western Electric Co. is already moving away from dependence on gold: A new circuit board manufacturing process announced in November could save about $12 million a year by replacing some gold with copper and nickel.

Demand stays up. Despite these moves, however, many experts predict that the longer-term industrial use of precious metals will be up. Platinum, for example, whose price has increased some 65% in one year, is still in high demand because of its superior performance in catalytic applications. Palladium, a metal often mined with platinum and classed with precious metals, is being substituted increasingly for both platinum and gold—and its price is just one-third that of gold.

Companies that must buy precious metals for consumer products also are feeling the pinch from rising costs. But in sterling ware and jewelry, some manufacturers are seeing demand increase despite sharply higher prices. "We've raised [sterling ware] prices about 100% in the last 12 months," says W. Gerald Newmin, president of International Silver Co. But he adds that the company is now seeing growth in sterling flatware for the first time in two decades. "People visualize sterling as having intrinsic value that is going to appreciate," says Newmin. "Obviously, they are hedging against further inflation." ■

[redacted]

30 THE WALL STREET JOURNAL
Friday, Feb. 15, 1980

Commodities

Peru Sustained Loss of About $80 Million Because of Speculation in Silver Futures

Special to THE WALL STREET JOURNAL

LIMA—Peru, one of the world's largest silver-producing nations, has found that making money from the recent huge rise in silver prices isn't as easy as it might seem.

Government officials acknowledge that the national treasury has had a loss of about $80 million because of speculation in silver futures by the government's metal-marketing agency, Minero Peru Comercial, or Minpeco.

The losses resulted from the short sale of futures covering about 13.5 million ounces of silver last October, when silver's price was about $17.50 an ounce. Minpeco officials took the position because they thought silver's prices would fall. Instead, it rose sharply and when Minpeco covered its position in December, the metal was around [illegible] an ounce.

The ill-fated speculation led to rumors in the U.S. that Peru had been unable to cover resulting margin calls and had created financial difficulties for the clearing house of the New York Commodity Exchange, and for two brokerage firms handling Peru's accounts: Merrill Lynch, Pierce, Fenner & Smith Inc. and E.F. Hutton & Co.

The rumors were vehemently denied in Lima and New York. A top Minpeco official declared: "We have paid everything and we don't owe a thing to anybody." John Conheeney, head of Merrill Lynch's commodity division, declined to discuss whether his firm was doing business for Peru, but he said he could "categorically deny that we've had trouble meeting margin requirements for any account."

David Johnston, a senior vice president of E.F. Hutton and a member of the Comex Clearing House, which guarantees transactions on the Comex, also denied the rumors. "The clearing house isn't in any trouble," he said. "It's all a matter of fancy."

Back in October, though, there seems little dispute that Minpeco was short, or committed to deliver, 13.5 million ounces of silver, which isn't an unusually large amount given Peru's annual silver production of about 40 million ounces.

Commodity producers often take short positions if they think the price of goods they expect to sell later will fall; then profits on futures can offset lower revenues on sales. The process is known as hedging. But apparently Minpeco didn't have silver to sell to cover more than about 3.5 million ounces of its futures position.

According to Minpeco officials and Peruvian government banking sources, Minpeco began hedging on behalf of local silver-mining companies last August. The agency acted as a go-between, taking orders from the companies, and few of its executives knew the trading techniques involved, the sources said.

In October, Minpeco's hedgers established a short position of 13.5 million ounces of silver for the agency's account, in the belief that the metal's then-record price of more than $17 an ounce would drop. The transactions were made through Merrill Lynch and E.F. Hutton, the sources said. Of the total, Minpeco had silver to cover only 3.5 million ounces of its obligations, they added.

After falling briefly to about $16, the price climbed past $18 and Minpeco's brokers began asking for more margin money. In futures markets, losses must be settled and profits accrue at the end of every trading day. It was only when the hedging department asked for more money that top Minpeco officials realized what had happened, the sources said.

For two weeks in December, officials of Minpeco and of the government's central bank debated whether to cover the agency's position or hold on and hope silver's price would fall. It was decided to cover the approximately 10 million ounces of futures for which the agency didn't have metal to deliver. That was done at an average $25.50 an ounce, for an accumulated loss of about $80 million, Minpeco said.

Peruvian officials believe that Minpeco's need to buy 10 million ounces of silver futures in late December, to cover its short position, contributed to the metal's sharp rise at that time. Indeed, between Dec. 20 and Jan. 2, silver's price for current month delivery jumped to $38.85 an ounce from $32.50 on the Comex. The approximately 3.5 million ounces of futures that remain outstanding are covered by metal whose selling price will make up for the corresponding futures losses, the sources said.

Ironically, higher silver and petroleum prices have helped Peru recover from serious financial difficulties two years ago. The balance of payments is in the black and the government recently was able to repay [illegible] million in emergency refinancing credits granted late in 1978. Thus, analysts conclude, Peru was in a financial position to cover Minpeco's hedging operation, even if it proved a costly lesson.

It proved costly for Minpeco's top management too. Last week, the government fired the agency's board and senior officials and announced plans to merge Minpeco into Peru's central bank.

Metals

Hysterical

Who's cornering us now?

The metal commodity markets are giving industry a hard time. The sharp price rises of the past few months have created difficulties, but the more recent movements in the markets are the truly worrying problem.

The electronics industry, for example, could certainly adjust to still higher copper prices. The American car industry, by changing the platinum content of exhaust emission converters, could learn to live with record platinum prices. But this sort of shift takes time and money, whereas changes in the commodity markets seem to be becoming ever more sudden and violent. Uncertainty imposes costs, and those speculators who are hedging against political inflation risks are helping to increase uncertainty, not smooth it out.

Prices of platinum and tin reached record highs in early March of over $1,030 an ounce and over £8,400 a tonne respectively. For once, the platinum price rise was not merely reflecting a similar shift in the gold bullion price, which has fallen below $600. Dealers wonder if American and Arab interests, acting independently or in harness, are trying to corner the free market in platinum, which represents around 10% of overall physical platinum turnover. Ominously, activity has seemed to centre on the New York Mercantile Exchange's platinum futures contract, where speculators can buy "paper" platinum on margin.

A successful corner in free market platinum is not a welcome thought for platinum consumers, who use it to top up their supplies. And Rustenburg Platinum Mines and Impala Platinum Mines, the two South African producers who account for the majority of the world's output, are just as unhappy at the prospect.

They have kept their price at $420 an ounce in the hope of dissuading consumers from spending too much money on research on substitutes. So far industrial demand seems to be holding up, but jewellery demand, particularly in the key Japanese market, is perhaps 25% lower than a year ago.

Tin's dramatic rise was triggered by a Carter administration decision, reflecting strong tin producer pressure, to delay disposals from its strategic stockpile until July. Originally they were scheduled to commence this month at a rate of 500 tonnes a month. Consumers hoping to benefit from the likely bearish effect on prices had been doing their best to live off stocks. When the news broke they scrambled to cover themselves and speculators, not surprisingly, piled in as well.

By early this week both markets had crashed, once again underlining the volatility of metal prices for the moment. Free market platinum was around $850, tin had dropped around £700 to around £7,750 a tonne.

For the moment silver, which topped £20 an ounce on the London Metal Exchange earlier this year, has dropped to around £13.50. Should consumers be cheering? Not really. The price is still twice as high as it was six months ago and Mr Nelson Bunker Hunt is controlling upwards of one fifth of readily available supplies. Anything could happen to the price, more or less overnight.

Not surprisingly, the silver market's performance is causing industrial casualties. Europe's largest photographic firm, Agfa-Gevaert, which had to have a injection of DM300m from one of its partners (Bayer, the West German Chemical giant) is still unhappy. Its boss said this week that he could not rule out the need for more cash in the future.

The slightest rumour of a shift in underlying demand or supply can send prices moving. In the last week of February lead gained £100 a tonne on the London Metal Exchange, an increase of roughly 20%, following a squeeze on stocks aggravated by a strike at Britannia Lead's British refinery. By early this week all that gain had gone.

Some movements defy the underlying facts, too. Zinc managed to top £400 a tonne in the middle of last month, although one of its major uses is for galvanising steel—and Britain's steel strike was steadily gathering pace. It managed to hold on to most of this gain until early this month, when it was caught in the grip of the latest speculative sell-out.

Copper, the LME's most famous metal, with a wide range of industrial uses, has also been giving consumers palpitations. From below £1,000 a tonne at the beginning of the year it oscillated violently to levels not far short of the all-time spot high of £1,400 a tonne achieved during the 1974 commodities boom.

Consumers cannot complain too much about the levels achieved, as the metal has been undervalued for some time. But the manner by which they were reached, with the market in the grip of speculators spilling over from the precious metal markets, was unnerving. The copper price is now back to £1,050, not far from its starting point 10 weeks ago—but for how long?

The Economist March 15, 1980

WSJ
March 24, 1980

Silver Prices Continue To Cause Confusion In Photo-Supply Field

A WALL STREET JOURNAL *News Roundup*

Fluctuating silver prices continue to cause confusion in the photo-supply industry.

GAF Corp., New York, said it discontinued X-ray film production due to "sharply increased and chaotic" prices of the metal. Separately, Dallas-based Fox-Stanley Photo Products Inc. said the recent drop in silver prices wouldn't affect this quarter's earnings adversely.

And, in Rochester, N.Y., Eastman Kodak Co. denied photo industry rumors that it planned to roll back a 50% photographic paper price increase because of the recent decline in silver prices.

Silver, which sold for a record $50.35 an ounce in New York in January, fell as low as $16 an ounce last week and closed at $22.50 an ounce Friday. The metal is used extensively in making photo film, paper and chemicals.

GAF said the halt in the production of X-ray film, as well as related chemicals, would result in layoffs for 500 workers at its Binghamton, N.Y., plant, and 130 sales and administrative jobs at other locations.

The company said the closedown of X-ray film manufacturing, which was blamed in part on rising costs of capital, wouldn't have a "material" impact on first quarter earnings.

The maker of chemical, building and photo products said it would continue making graphic arts and reprographic products at the Binghamton facility. The graphic arts operation uses about half the silver consumed by the production of X-ray film, GAF said. The company added that silver accounted for 75% of the cost of X-ray film manufacture, up from 30% a year ago.

Unlike GAF, Fox-Stanley said that it doesn't profess a "major concern" over silver prices and that it still expects a strong fiscal fourth quarter to push earnings for the year ending March 31 above $1.70 a share.

In fiscal 1979 the photo-finishing concern posted net income of $5.5 million, or $1.60 a share, on sales of $115.7 million. Two months ago Fox-Stanley said it expected fiscal 1980 net to rise between $1.70 and $1.75 on sales of $135 million to $138 million.

In recent weeks Fox-Stanley shares have fallen in New York Stock Exchange composite trading. Fox-Stanley closed Friday at $8.50 a share, up 12½ cents for the day but down from the $10.625 price posted three weeks earlier.

In its latest statement, Fox-Stanley sought to alleviate any concern that it would be seriously hurt by declining silver prices. Because of the drop, it noted, it "appears" that a 50% price increase in photographic paper previously announced by Eastman Kodak and other suppliers "won't be implemented." Price boosts are still expected, Fox-Stanley said, but "they shouldn't be as severe as originally announced."

A Kodak spokesman said, however, that the 50% price increase was implemented Feb. 28. "As of today, there hasn't been any refinement of those increases," he said, "and we aren't in a position to project future action."

NRT Metals Gets Caught in Crash Of Silver and Loses

* * *

Unable to Meet Margin Calls, Firm Now Can't Pay Bills That Total $4.5 Million

By Roger Lowenstein

Staff Reporter of The Wall Street Journal

Michael Cameron, president of NRT Metals Co., tried Friday to place a call to Nelson Bunker Hunt.

"I never met the man," said Mr. Cameron, "I just wanted to compare notes, because Hunt was hit by the same thing I was," the recent crash in silver prices.

With this difference: The Texas billionaire is still riding the range, but NRT is going out of business. The trading concern, which did $50 million of business last year, can't meet its $4.5 million in bills.

Piecing the Story Together

Mr. Cameron, a Briton and former trader on the London Metal Exchange, refused to discuss NRT's collapse. However, financial sources in New York and London pieced together an account of the concern's fall.

Essentially, NRT was caught in silver's unprecedented boom and bust.

In normal times, the member of the New York Commodity Exchange often "sold short," or committed itself to deliver silver in the future. It balanced these futures contracts by buying the metal itself, including five tons a month from Minpeco, the Peruvian minerals-export agency.

Last fall, however, the price of silver began to skyrocket. Minpeco, which has speculated in futures markets that silver's price would drop, lost heavily and couldn't deliver 10 tons of silver it had promised NRT.

As a result, NRT was badly exposed: it was forced to deliver silver that it could obtain only at high prices and lost about $10 million.

'Encouraged' Aid

The concern was close to "going under" in January, one source confided.

However, Compagnie Bruxelles-Lambert, a Belgian company that owns 40% of NRT, "encouraged" London metal brokers to aid the trading concern, and NRT officials went to England to work out an arrangement.

NRT then seemed to bail itself out by selling options for London brokers to buy silver at fixed, relatively high prices. But there was a catch: the brokers could back out of the options.

And, when silver's price began to plummet in February, that's exactly what many of the brokers did. Suddenly, NRT was exposed on the other flank; it had bought high-priced silver futures to deliver to the London brokers, but didn't have enough customers to dispose of the metal.

Margin Calls

On March 13, NRT met its Waterloo. Rudolph Wolff & Co., a British concern that had bought silver futures partly on credit for NRT, put out a margin call, or request for more collateral. The British concern wanted more money as the value of NRT's silver futures began to plummet.

NRT, sources say, asked for time to come up with cash; Rudolph Wolff refused. The next day, Rudolph Wolff liquidated NRT's contracts at silver's low price, forcing the company to take a loss.

"It's a standard thing in the industry," a spokesman for Rudolph Wolff in New York said. "If someone doesn't meet margin calls you liquidate them."

Other London metal brokers also liquidated NRT contracts. The company's total bill came to $4.5 million; its assets are only $1.5 million.

Metal traders in New York, meanwhile, presumably took heed. "I was shocked," one local analyst said. "They always had a good reputation."

WSJ MARCH 31, '80

Collapse of Silver Isn't Expected to Bring Bargains Soon for Consumers or Business

By CYNTHIA SALTZMAN

Staff Reporter of THE WALL STREET JOURNAL

Consumers and businessmen looking for bargains as a result of last week's silver-price collapse will find selective price cuts showing up on some items. But broad-based discounts aren't likely soon.

That's the assessment of manufacturers of sterling, photographic products and other products following the crash that saw prices drop about $10 an ounce in two days. Silver prices on the Comex went as low as $1[illegible].80 an ounce Thursday and closed Friday at $12. It had been as high as $50 an ounce in January.

Silver and other commodity prices have been dropping steadily as interest rates have climbed. Higher interest rates are bearish for commodity markets because the costs of financing inventories begin to outweigh the potential for price increases. The dollar and other interest-bearing assets, by comparison, become much more attractive investments than commodities, which yield neither interest nor dividends.

In Washington, Walter L. Frankland Jr., executive vice president-secretary of the Silver Users Association, described the sterling market as being in "complete confusion. Everyone is stepping aside and watching."

In Wilmington, Del., Du Pont Co. vice president John Metzger said that while the company's film prices are beginning to drop, "the situation is so unpredictable it's impossible" to forecast price moves. The company buys about 17 million ounces of silver a year for its X-ray, graphic arts, industrial and other types of film.

Some retail price cuts have already shown up. Late last week, Tiffany & Co. said it was widening its discount on all its silverware to 25% from the previous 15%. "We wanted to make sure our customers benefited immediately," said Henry B. Platt, president. And Lunt Silversmiths in Greenfield, Mass., cut the suggested retail price of its most expensive place setting to $416 from a high of $940 in January.

Eastman Kodak Co., which buys 30 million ounces of silver annually, cut the price of X-ray film 10 days ago 9% to 13%, and cut prices of graphic arts films and papers 10%. Last Friday, the company said it was "watching the situation very closely for signs of stability" before making any further cuts. "We want to avoid pricing our products based on daily or weekly fluctuations in silver," a spokesman said.

Manufacturers of sterling silver, over 90% of which is silver, estimate that unit sales of sterling flatware and other products have fallen more than 50% for the first two months of the year compared with the year-earlier period. Some say dollar sales have stayed about even.

In Dallas, Robert Ackerman, merchandise manager of giftware for Neiman Marcus Co., said that even with recent price cuts, sales of silver remained slow. He thinks people are waiting for it to hit bottom. Neiman Marcus is a division of Carter Hawley Hale Stores Inc.

The silverware buyer is confused, said Denham Lunt Jr., president of Lunt Silversmiths. He said that two weeks ago suggested retail prices for five competing heavyweight place settings ranged from $486 to $826.

The reduction in value of inventories bought when silver prices were $20, $30, and $40 an ounce worries some manufacturers. Bryce Blair, vice president of sales at Reed & Barton Corp., a Massachusetts silver concern, said that the drastic drop in silver prices is "going to give us an awful lot of problems . . . because of the inventories that were purchased at higher prices. We've been buying silver right along. If it stays down, we'll lower prices. They (the stores) will have to take markdowns." He described industry inventories as "quite high because sales dropped off so suddenly."

Charles Goodrich, vice president of Silverfab Corp., a Connecticut company that makes silver-plating anodes, said that orders "snowballed" Friday. He estimated orders were up 70% from normal. He said many of his customers are small electronics concerns. "They got ripped off so badly when the price went up that they're trying to take advantage of the situation now."

Mr. Goodrich also said that last week refineries were reluctant to sell silver at $10 an ounce. "It's difficult to buy scrap at $10 unless it's new to the market."

Regarding the collapse of the silver market, Mr. Lunt is among the optimists: "We couldn't have hoped for anything better. We now have the raw material at a price level somewhere near the cost of what it really takes to get it out of the ground." But he said the possibility that the market may again skyrocket "worries me more than anything."

"It (silver refining and manufacturing) is a chain," said Mr. Goodrich, "and someone somewhere along it is getting hurt."

Separately, silver-mining companies reacted grimly to the price collapse, but said that it wouldn't significantly alter their production plans.

"We had been planning to mine ore that was a little thinner, but if these prices hold we might not do that," an official at Rosario Resources Corp. said. Other companies said silver, at $12 an ounce, remains high enough to justify their current expansion plans.

But all companies conceded that silver's drop from $50.35 an ounce in January will mean big losses for them. An official of Hecla Mining Co. in Wallace, Idaho, said each $1 drop over a year's time in the price of silver costs the company about $3.5 million annually.

Asarco Inc., another big producer of silver, said each $1 drop, sustained over a year, in silver's price, would cost it $10 million.

Companies were particularly upset over their inability to estimate their silver revenues, which depend on silver's price on commodity markets. "We're concerned about the turbulence in the market," said Charles Barber, chairman of Asarco. "U.S. industry used only 175 million ounces of silver last year, while 34 billion ounces traded on futures markets."

Gulf Resources & Chemical Corp. of Houston said declines in silver prices won't affect its earnings or previously announced plans to expand silver refinery production. However, the company acknowledged it won't be making as much as it would have if silver prices had stayed high. It said fluctuating markets disrupt its contract settlement and hedging activities.

Gulf Resources produces about 2.3 million ounces of silver a year and expects to refine a total of about 10 million ounces this year.

WSJ March 31, '80

INTERNATIONAL MONEY MANAGEMENT

Silver leaves a global casualty list

The collapse of silver prices is putting powerful liquidity pressures on institutions and investors not only in the U. S. but all around the world. Particularly in Europe and the Persian Gulf, banks, merchants, and speculators suddenly find themselves in a massive squeeze, and their flight into the comparative safety of the dollar is taking on stampeding proportions. Lured also by interest rates as high as 20% for three-month Eurodollar deposits, investors are pouring out of the commodities markets: The U. S. currency has shot up 4% against the German mark since Mar. 25, the day before Nelson Bunker Hunt began selling silver to meet his margin calls.

Ironically, the liquidity squeeze that silver's collapse is producing abroad is having severe consequences for some U. S. corporations. When Belgium's Banque Bruxelles Lambert recently sued Chrysler Corp. for $10 million in overdue payments, it cited liquidity problems of its own. The bank also owns 40% of NBT Metals Inc., a member of the New York Commodity Exchange that is going out of business under the same pressures that have driven a number of big Wall Street firms close to collapse. Nearly half of Chrysler's $800 million of outstanding debt is held by foreign banks, and just as one of them is the first bank to feel the liquidity squeeze hard enough to sue Chrysler for cash, others may find that they cannot meet all the commitments they have made for lines of credit to U. S. corporations.

Hunt's partners. In addition to NBT and brokers caught by the plunge in silver (page 27), other sufferers from the silver collapse are likely to be Hunt's Arab partners. According to one London-based foreign banker: "Two years ago Hunt wrote 50 letters to wealthy Saudis explaining why silver was bound to rise and asking them to join with him in a syndicate. He didn't go through any middleman, and he got several people to join." One partner is Sheik Abdullah al-Amoudi, a wealthy Saudi of Yemeni extraction who is also heavily into real estate. Another is Mahmoud Fustok, a Saudi contractor of Palestinian descent, and a third is Saudi Prince Faisal bin Abdullah al Saoud, a grandson of the founding member of the Saudi dynasty. Joining this group is Naji Nahas, a Lebanese international commodities trader who works out of São Paulo, Brazil. Nahas is known to have speculated very successfully in the coffee market.

How much Hunt's Arab partners lost remains unclear, but al-Amoudi and Fustok are said to have personally invested at least $100 million each—and the others a lot more. The biggest impact of the silver disaster, however, may be felt in the thousands of bazaars around the Persian Gulf where some very big merchant families—the foundation of political stability in countries such as Kuwait, Bahrein, and the Emirates—have lost fortunes in the past eight weeks. Silver and gold fever swept through the Gulf in January as merchants bought the precious metals at their peak price levels. They now find themselves holding assets of plummeting value and cannot sell them without huge losses.

Some victims of Hunt's big silver play are likely to be his Arab partners

Some more fortunate Arabs got out when silver was in the area of $50 per oz. During the summer, many Kuwaitis and Bahreinis joined together to form a company—Gulf Investment Co.—that traded silver in Paris through the Arab consortium bank BAII. The company bailed out in January with profits of $22 million and was so thrilled with its gains that it made plans to join with Hunt in a new venture called Gulf Precious Metals (GPM). Hunt was supposed to ante up 10% to 20% of the $500 million in capital for the new company and the Gulf Arabs the rest.

Failure. According to Sabah Al-Rayis, a wealthy businessman in Kuwait, GPM was able to raise only half the targeted amount by the middle of March. Other sources say that Hunt spent several days in the Gulf earlier in the month trying to get the Arabs to come up with additional capital. His failure may have been the first signal that the big silver play was falling apart. With the extra capital, Hunt might have bolstered the price of silver and staved off his margin calls.

Another Hunt failure that seems imminent is his plan to sell silver-backed bonds to small investors around the world. Hunt is unlikely to get much support for the program in the Middle East, despite his recent three-day visit to Riyadh. "A lot of people [in the Mideast] who bought silver got burned badly," says Tarek J. Kassem, chief executive of Arab Investment Bank in London. "They will be wary of going in for more." Just as important, the collapse of the silver price has thoroughly frightened potential U. S. investors and made many Europeans thoroughly dubious about the silver-backed bonds.

There is some doubt in Europe, in fact, that the bonds were anything more than an idea dreamed up to stem the decline of silver and generate fast cash for Hunt and his partners. None of the big European banks that would have been involved in a possible sale of billions of dollars in bonds was ever contacted by the Hunt-Saudi syndicate. ■

38 THE WALL STREET JOURNAL, Monday, June 23, 1980

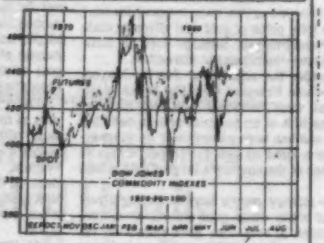
Commodities

Comex Seems to Be Suffering a Hangover As Trading Plunge Follows 1979's Boom

By Julie Salamon

Staff Reporter of The Wall Street Journal

Commodity Indexes



	Close	Net Chg.	Yr Ago
Dow Jones Futures	442.29	– 0.25	440.31
Dow Jones Spot	431.77	+ 2.69	438.99
Reuter United Kingdom	1672.5	– 2.3	1640.9

NEW YORK – After years of struggling to compete with the two big Chicago futures exchanges, the Commodity Exchange last year began to sip the sweet wine of success.

Though it remained the nation's third largest futures mart, the Comex gained international prominence and profited handsomely as gold and silver fever raged. Heady, with its good fortunes, the exchange added two new financial futures contracts to its mainstays, precious metals and copper futures, and heralded plans to open a "satellite exchange" in Los Angeles.

This year: The hangover. The recession has chilled speculative ardor for copper and gold. The Hunt silver crisis left that market, once the Comex's busiest, nearly shattered. As a result, Comex trading volume declined 29% during the first five months of this year from 1979, while other leading exchanges expanded.

And, Comex's venture into the hot, new financial futures market has lolled in the shadow of its Chicago competitors. Open interest, or the number of contracts outstanding, for the Comex's futures contract in government-backed securities is 1,138, compared with 63,664 on the Chicago Board of Trade. In Treasury bill futures, the Comex has an open interest of 261 compared with 22,920 at the Chicago Mercantile Exchange.

Though many of the Comex's current woes stem from the downturn in the general economic climate, many critics say the exchange's managers were too willing to view last year's commodity boom as permanent. "They were ready to take over the world," a senior official in a New York brokerage firm says. "They didn't have any perspective on what would happen if the tables would turn."

The exchange has been criticized especially for failing to get its financial futures contracts off the ground, particularly since New York is the nation's center for banks, potentially major commercial users of them. Comparisons are frequently made with the Chicago exchanges, where big floor traders, the professional speculators who provide the necessary liquidity to the market, were urged strongly by those in charge to put their money into the new contracts.

That comparison "is a little unfair," Comex Chairman Lowell Mintz, a big floor trader, says. "We do things differently here." Comex traders don't respond to "arm-twisting," another official says.

A successful finanical futures market would help the Comex diversify its products, which currently include only metals. Ironically, the new contracts were launched last fall when there was "explosive volume in gold and silver. People found there wasn't any need to pay attention to the T-bill market," Arthur Marcus, director of commodities for Dean Witter Reynolds Inc. in Chicago, says.

The new contracts were neglected, too, as exchange officials became increasingly concerned over the Hunts' big play in silver and a group of wealthy Arabs, which eventually led to the market's near collapse in March.

Most importantly, the exchange's own traders apparently aren't too keen on learning about the new contracts. "Comex should concentrate on its strengths – the precious metals," one trader grumbles. Mr. Marcus of Dean Witter says, "It's always tough to teach old dogs new tricks. That floor crowd is oriented to gold, silver and copper. They don't want to learn a new game."

Comex floor traders are even less enthusiastic about the new contracts as the futures unit of the New York Stock Exchange, which will trade similar contracts, prepares to open. "Many people were looking to the possibility of the new futures exchange getting started and wanted to wait and see what happens before they get involved in trading financial futures." Lee Berendt, Comex president, says.

Still, the exchange plans to go ahead with its expansion into Los Angeles, although the West Coast edition of Comex won't open this fall as previously anticipated, a spokesman says.

"We've been battered, but we're surviving," Mr. Mintz, the chairman, says. An exchange member adds, "Sure we'll survive. But we should survive with a little more humility."

Soaring Prices of Metals Spur Marginal Mining

WSJ July 3, '80

By Julie Salamon
And Roger Lowenstein
Staff Reporters of The Wall Street Journal

The lofty price of gold and silver is making precious-metals mining—even in marginal areas—increasingly attractive.

Consider the activity at Jerritt Canyon, Nev., where Freeport Gold Co. began blasting last week. Although the site contains only one-fifth of an ounce of gold in each ton of ore and has been passed over by prospectors for a hundred years, Freeport hopes to build one of the country's largest gold mines there.

The skimpy return isn't deterring Freeport, or many other gold and silver mining companies. In fact, they have redoubled exploration programs and are busy refining low-grade ores that just weren't worth the trouble previously. While off from 1980 highs, gold's price of about $600 an ounce and silver's price of nearly $17 are providing mining companies with ample justification for their efforts.

Earnings Soar

Already profits from higher price levels have, in percentage-increase terms, put mining companies in the same league as the major oil producers. First quarter earnings of Homestake Mining Co., which owns the biggest U.S. gold mine, rose 160% from a year ago to $29.9 million. Sunshine Mining Co., a major silver producer, reported first quarter earnings of $2.8 million, up 87% from a year earlier. Hecla Mining Co., another big silver producer, quadrupled its first quarter earnings, to $25 million.

Surprisingly, fancy profits and stepped-up activity haven't meant increased production for the precious-metals industry. Output from gold and silver mines is down worldwide, reflecting a variety of production difficulties. But more important is the decision of some companies to ignore their richest ore for the time being in favor of ore with a lower metal content.

Profits Still High

When metal prices are high, companies can make as much profit on ore that costs more to mine or has a smaller metal content as they can on richer ores when prices are low. And because processing capacity doesn't change much, sending lower grade ore through the refinery means less gold and silver in the finished stage.

In Australia, Newmont Mining Corp. expects production to drop at its 70%-owned Telfer gold mine as the average ore-grade drops. Gold's increased price "has extended the life of the mine," says Wayne E. Burt, Newmont's senior operations vice president. "It will allow us to produce from areas where the grades once were considered too low."

In South Africa, the world's largest gold-mining nation, companies are required by law to mine lower-grade ore when prices increase. As a result, gold output there fell slightly in 1979, to 22.6 million ounces from 22.7 million ounces a year earlier.

In the U.S., where much gold and silver is produced as a byproduct of refining baser metals, such as copper and zinc, gold production last year fell to 910,000 ounces from 990,000 ounces in 1978. W.C. Butterman, a Bureau of Mines gold specialist, says U.S. gold mines produced "leaner ore" in 1979, accounting for the production drop.

The strategy of turning to lower-grade ores as metal prices rise applies to silver as well. "Obviously, we can mine ore that we couldn't mine at $5 an ounce," says David Wagner, a Sunshine executive vice president. In the past, Sunshine didn't touch ore that contained fewer than 15 ounces of silver a ton. Now the cutoff is eight or nine ounces a ton.

At its huge mine in Idaho, which has been on strike since March 14, Sunshine is even settling for less. The mine has managed to continue operating at 10% of its capacity by processing waste rock which assays at three ounces of silver a ton.

Idaho Activity Increases

The new emphasis on exploiting lower-grade ore means opening new pits and expanding shafts and tunnels. Much of the activity is centered on the small towns of Idaho's panhandle, where deposits deep in the folds of the Rocky Mountains form the world's richest silver lode.

Hecla Mining is digging a new shaft in its Lucky Friday mine and is rehabilitating an old mine near Osburn, Idaho. Six miles away, near Kellogg, Sunshine Mining plans to deepen the shaft on the western flank of its mining property to 5,800 feet from 3,700 feet. This will increase Sunshine's capacity to eight million ounces of silver a year from 5.5 million ounces.

Asarco Inc. expects to develop up to three new silver mines in the Western U.S. if difficulties in separating the metal from ore in the area can be resolved. "At $40 an ounce, metallurgical problems wouldn't be so important," says Norman Visnes, Asarco's vice president of mining. But if silver were still priced at $6 an ounce, "those projects would still be on the shelf," he says.

Technology Helps

Technological breakthroughs are helping make the mining of lower grade ores more feasible. At Cerrillos, N.M., a dusty crossroads in the hills of Santa Fe, Consolidated Gold Fields Ltd. is experimenting with a new process that is expected to be cheaper and less cumbersome than traditional deep-shaft mining.

The process is called the "heap-leach" method with gold being extracted from ore chemicals. The drawback is the low rate of gold recovery. Consolidated Gold Fields expects to produce less than 0.1 ounce of gold from each ton of rock at Cerrillos. That compares with 0.2 ounce to 0.8 ounce a ton from the average deep-shaft operation.

But if the method works, the British company "could exploit properties around the world," says a Consolidated Gold Fields' executive.

The Washington Star

Business & Finance

MONDAY, JULY 28, 1980

Hunts' Silver Dealings Contributed Heavily To Slump, Reuss Says

"The Fed's heroic controls are in large part responsible for the growing recession."

The Washington Star

Rep. Henry Reuss, chairman of the House Banking Committee. Inset: Herbert, left, and Nelson Bunker Hunt shown at a Senate hearing in May.

By Sheilah Kast

Washington Star [illegible]

The chairman of the House Banking Committee says he believes silver speculation by the billionaire Hunt brothers contributed heavily to the current recession.

The link between the two, according to Chairman Henry Reuss, D-Wis., is the huge bank loans made to the Hunts early this year. A recent report by the Federal Reserve Board said the Hunts received 9 percent of the new loans which U.S. banks made during February and March.

Faced with such an increase in bank lending, Reuss said, the Federal Reserve on March 14 moved more harshly than necessary to tighten credit.

"These heroic controls are in large part responsible for the growing recession," he concluded.

Federal Reserve officials said they disagree with Reuss' reasoning that the Hunts' silver speculation is a major cause of the recession. While the Hunts received a large share of the increase in bank loans during February and March, the Fed officials argued, their borrowing represented a much small portion of total outstanding balances.

They also contended that much of the money the Hunts borrowed from banks was used to pay off debts at brokerage houses, and that money in turn was placed back into banks or into other parts of the economy. In essence, they argued, the Hunts were part of a chain of borrowing that probably would have taken place without them.

Reuss raised his complaint — that the Federal Reserve had failed to monitor banks to make sure they complied with Fed requests to stop making loans for speculative purposes — at a hearing last week. But he did not ask his sole witness, Fed Chairman Paul A. Volcker, whether he agreed that the loans to support the Hunts' silver speculation bear heavy responsibility for the current recession.

Reuss did ask Volcker to explain why the $1.1 billion loan which allowed the Hunts to refinance their silver debts in May did not block Nelson Bunker Hunt's daughter from buying a 4 percent interest in a silver mine.

Reuss noted that Volcker, who had supported the loan, had promised Congress the terms of the loan would prevent brothers Nelson Bunker and William Herbert Hunt "or any related entity" from speculative activity.

"What could be more related than your own darling daughter?" Reuss demanded.

Volcker responded that the term "related entities" does not cover blood relatives of the Hunt brothers, but individuals or businesses which have speculated in silver with the Hunts in the past.

The Hunts had acquired futures contracts to take delivery on millions of ounces of silver. When silver prices started falling from a peak of $50 an ounce on Jan. 21, the value of the contracts dropped, too. The Hunts had to raise cash to pay their brokers and metals dealer; the $1.1 billion loan was arranged to consolidate the Hunts' debts.

Volcker's response came after several congressional committees have already questioned whether the Hunt family will end up making a profit on their silver speculation, even though they have been forced to pledge most of their possessions as collateral against the $1.1 billion loan.

spring, Rep. Benjamin S. Rosenthal, D-N.Y., told them, "It looks to me like the Federal Reserve is shepherding along a loan for $1.1 billion so you and your colleagues won't have to sell any silver in a depressed market."

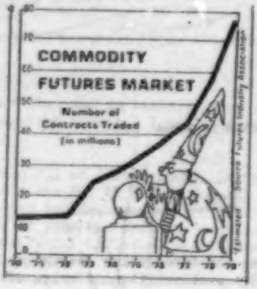
An interview with the Hunts in the current issue of Fortune magazine lends support to Rosenthal's theory. Herbert Hunt told Fortune that none of the family's 63 million ounces of silver has been sold since the loan was worked out.

He said he did not expect any silver would be sold until the price rises to about one-fifth the value of gold. Using current gold prices as an example, that would be about $130 per ounce of silver, compared with its current price of about $17 an ounce.

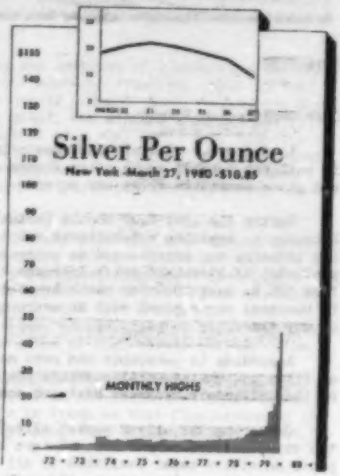
Reuss said in an interview he was not criticizing the Fed "for clamping on stern controls" on credit during March, after the loans had been made.

But Reuss said, "The best way by far would have been to prevent banks from making those loans at all." He suggested that banks should have been required to file detailed reports after the Fed asked them last October to stop making loans for speculative purposes.

GROWTH IN FUTUREL TRADING 1970 - 1979



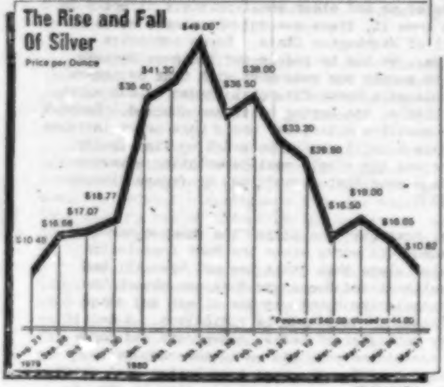
SILVER FUTURES BETWEEN 1972 - 1980



Silver Per Ounce

New York -March 27, 1980 -$10.85

SILVER BETWEEN AUG 31, 1979 - MARCH 27, 1980



The Rise and Fall Of Silver

—Washington Star

B Franklin

The Franklin Press · Printers & Typographers · [illegible] Washington [illegible]

COMMENTS:

4-14-1980

Dear Congressman Rosenthal,

As the owner of a six-employee printing and typesetting company my survival in business depends among other things on the availability and price of papers and photo sensitive films and papers.

During the last four months (actually six months, I started this letter in February -- anything non-business related takes months to be completed) the printing industry has experienced an unprecedented price increase in silver containing products, an overnight price increase that just about ruined me. Increases ranged from 50% to over 100% for photo typesetting papers. I have never in all my years in business experienced such an unproportional high inflation rate for any product at any time.

According to newspaper and news magazine articles the tremendous price increase of films and photosensitive papers was caused by the speculative buying of silver by the billionair brothers Hunt and some Arabs.

Cornering the silver market affected me and other small printers directly in two ways: before many small printers knew it, there was not one single sheet of photo sensitive paper available in all of Washington State. Large companies bought up all supplies at the old price. We had to reduce our business because we did not have enough raw materials to supply our customers with type or camera work. The sudden decrease in income placed a heavy financial burden on our operation. When the paper was finally available, the buying price had doubled. General inflation, non-availability of photo sensitive materials, and a huge price increase nearly ruined my business. It will take 6 to 12 months to catch up financially. The combination of these three factors was the single most devastating experience I had in business. It is the first time ever that I can't pay my federal income tax. How can I explain this to the IRS?

I have read articles by financial "experts" who claim "the Futures market works and no government action is needed" (it works since the Hunt speculation backfired, they claim). Economists also claim that "this has not been all bad news since the stock market did not get hurt and Bache and Hunt can absorb the loss .... while the collapse of the speculative bubble in the silver and other commodity markets will help slow inflation". Now, this is ridiculous. A lot of peoole got hurt. Every printer, every publisher of books, newspapers and magazines, passes the new cost of silver containing products on to the customer. Both Seattle dailies raised their prices by 25%. The Hunt speculation cost every consumer in the U.S. every day. Inflation in printing is higher than in any industry except the energy industry. If economists can't look beyond Wall Street then there is something wrong with their perception. Too many small businesses

BFranklin

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fight for survival and an activity such as Hunt's does not help anybody, including Hunt and the stock market. I fail to see the blessing in disguise these "experts" talk about.

How could all of this happen? Certainly the invasion of Afghanistan and the hostage crisis can not be blamed for all of our economic troubles. What is the president doing besides praying and teaching Sunday school? What is Congress doing? How is it possible that two recklessly greedy men can use their wealth to create an artificial inflation within one segment of a very large U.S. industry that tops the general inflation some 5 times. I consider the Hunt action criminal, legalized robbery. I can't protect myself and my employees and customers from these money sharks who use the national economy as their plaything for their own fun and benefit.

I also would like to know how the Kodak Company gets away with monopolizing the market of photo sensitive materials. The price increase for films was 50%, phototypesetting paper over 100% -- although phototypesetting paper uses less silver per square inch than films. The reason appears to be that Kodak has virtually a monopoly on the phototypesetting paper market (GAF & Agfa have some materials available) while the film market is very competitive. I feel very frustrated about this shameless rip-off under the guise of high silver prices.

When the price for silver increased, Kodak increased its prices instantly, as if Kodak buys its supply on a weekly basis. I am convinced that Kodak has at any given time a large supply of raw materials in stock so that fluctuation of the market won't affect its production. Certainly, Kodak did not buy silver at $40.00 an ounce or even at a higher price.

The price for silver seems to have stabilized around $15. Less than one-third of its peak price. I have not yet received a price reduction from Kodak. They were very quick to adjust the price upwards. Will we have to accept their over 100% price increase as permanent?

No matter how the economy goes, I am getting ripped-off, consumers get ripped-off, and most small businesses get squeezed for every cent they earn by different government agencies, the IRS, and large corporations. Congress should spend more money to protect its citizens from the Hunts, the Kodaks and the bureaucrats of this country rather than from the Russians. We are destroying ourselves, we don't have to worry about any outsider trying to do that.

From the very beginning of my business experience I have come to realize that large corporations and government are the real enemy of small businesses. They keep us at the edge of bankruptcy, they keep us deluged with forms, new laws, an assortment of fines. They create shortages, inflation and price increases. They also keep me working 6 to 7 days a week, 14 hours a day and living on $6,000 per year in the back of my shop.

B Franklin

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Small businesses emnloy some 68% of the total workforce of the nation. This is possible because most owners work two shifts a day and invest an incredible amount of personal initiative to keep the business going and maintain their ulcers and headaches and constant exhaustion. With the Hunts and Kodaks and the government against us, the 68% figure is no small accomplishment.

Sincerely,

James Behrend

BENJAMIN S. ROSENTHAL
8th District, New York

DEPUTY WHIP
MEMBER, DEMOCRATIC STEERING
AND POLICY COMMITTEE

[illegible] Rayburn Building
Washington, D.C. 20515
[illegible]

U.S. Post Office
41-65 Main Street
Flushing, New York [illegible]
[illegible]

Congress of the United States
House of Representatives
Washington, D.C. 20515

COMMITTEE
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SUBCOMMITTEES
EUROPE AND THE MIDDLE EAST
INTER-AMERICAN AFFAIRS
GOVERNMENT OPERATIONS
SUBCOMMITTEE
CHAIRMAN—COMMERCE, CONSUMER
AND MONETARY AFFAIRS

RECEIVED
[illegible] AFFAIRS SUBCOMMITTEE

April 16, 1980

TO: BSR, Peter Barash, Barbara Timmer

FROM: Adrienne

RE: Silver Prices

Leon Mandell, a hearing aid dealer in Brooklyn, called today to express his concern about the impact of silver prices on consumer products, particularly hearing aids.

Hearing aid batteries are made with silver. A battery lasts 3-7 days. As of Devember 31, 1979, Mr. Mandell was selling 6 batteries for $4.50. In January that went up to $10.75 and in February to $17.50. Mr. Mandell charges 20% off list.

According to Mr. Mandell the price of silver has now gone down to $14.50, but battery prices have not gone down. The manufacturers are Duracell (Mallory), Rayovac and others.

Since hearing aids are a commodity utilized by the elderly and the handicapped, this price rise has particularly severe implications. Hearing aids are covered by Medicaid and so it involves public funds as well. Medicaid recipients can purchase a 3-month supply of batteries to save paper work. In December, this cost $13.50. Now the cost is $52.50.

Mr. Mandell would be happy to give you more information if you're interested.

Mr. Leon Mandell
Shawkaid
228 Livingston Street
Brooklyn, NY
625-2137

This could also have implications for dental bills which are also Medicaid covered.

May 05, 1980

RECEIVED
MAY 14 1980
SIDNEY R. YATES, M.C.

Honorable Sidney R. Yates (Congressman)
Chairman, House Appropriations Subcommittee
on Interior & Related Agencies
2234 Rayburn House Office Building
Washington, D. C.

Dear Chairman Yates:

I have just read an article in the Albuquerque Journal dated May 1, 1980 which indicates that Chairman Volker of the Federal Reserve Board testified before the Government Operations Subcommittee on Commerce, Consumers and Monitary Affairs supporting and requesting a $1 billion loan to bail out the Hunt brothers. As you know, I have spent all of my adult life on or near the Navajo Reservation. In that capacity I have become familiar with Navajo craftsmen including silversmith. Recently, I saw what Hunt's speculation did to these individuals who depended upon the sale of their silver work to earn a living. When the price of silver hit $50 it put these people out of work and even today when the price is approximately $12 they remain out of work.

Now for the government to bail out the Hunt brothers, because of their speculation, while the result of that speculation is not remedied in terms of its impact on the Navajos is unbelievable. Surely, it would be far wiser to use that $1 billion in some way which would benefit more Americans than to loan that money to the Hunt brothers. I have spoken with some of the traders that I trust and they are also indignant over this prospect of loaning such a huge sum of money to these individuals.

I hope you will do everything within your power to see that this does not take place!

It seems that everyone supports the capitalist in free enterprise system until such time as these huge corporations are in difficulty and then they abandon that approach and immediately run to the government to be bailed out. I do not understand such inconsistency.

Sincerely,

ROBERT A. ROESSEL, JR.
Rough Rock Rural Box 400
Chinle, Arizona 86503

mrd

SILVER USERS ASSOCIATION, INC., 1717 K Street, N.W., Washington, D.C. - 202 785-3050

FACT SHEET: Purpose of SUA, Inc.

The Silver Users Association, Inc., established in 1947, represents the interests of corporations that make, distribute and sell products in which silver forms an essential part. Association membership today includes representatives from the photographic, electronic, chemical, commemorative arts, silverware and jewelry industries; producers of semi-fabricated and industrial products; and mirror manufacturers.

A major purpose of the Association is to keep its members and the public informed on the pertinent developments in the field of silver; such as, production, consumption, availability, uses, prices, regulations and legislation.

The applications of silver are highly diversified and range from photography to missiles; from computers to sterling jewelry. An approximate breakdown of the silver usage in the U.S. shows these percentages: photography, 37.6%; electrical and electronics, 23.6%; sterling ware, 12.0%; brazing alloys, 6.9%; catalysts, 5.5%; jewelry, 4.5%; electroplated ware, 4.6%; commemorative and collectors arts, 1.8%; mirrors, 1.3%; and, all others, such as bearings, dental and medical supplies and rockets and missiles, 2.2%.

The Association estimates that its members account for approximately 80% of all silver consumed in the United States. More than 80,000 men and women work for Association members who are heavily dependent upon silver for manufacturing. In addition, there are about 1,500 firms of the Manufacturing Jewelers and Silversmiths of America and their 70-75,000 employees; and, the 22 members of the National Association of Mirror Manufacturers and their employees. The Association was incorporated in the District of Columbia in April, 1971.

President of the Silver Users Association, Inc., is Mr. Robert F. Wilson, President, Wallace Silversmiths. Mr. Jay Powers, Treasurer, Powers Chemco, is Vice President and Chairman of the Executive Committee. In addition to these two officers, other members of the latter committee are:

Mr. Nelson B. Colton, Engelhard Industries
Mr. Philip G. Deuchler, Handy & Harman; Treasurer, SUA, Inc.
Mr. George R. Frankovich, Manufacturing Jewelers & Silversmiths of America, Inc
Mr. Frank E. Grzelecki, Gorham Division of Textron, Inc.
Mr. Denham C. Lunt, Jr., Lunt Silversmiths
Mr. E. C. Mack, Eastman Kodak Company
Mr. Donald Schwartz, Medallic Art Company
Mr. Sinclair Weeks, Jr., Reed & Barton Silversmiths
Mr. John L. Whitehead, E. I. du Pont de Nemours & Company, Inc.
Mr. Robert Wiele, Minnesota Mining & Manufacturing Company

Mr. Walter L. Frankland, Jr., Executive Vice President-Secretary, SUA, Inc.

March, 1979 TAB "B"

Prepared by SILVER USERS ASSOCIATION, 1717 K Street, N.W., Washington, D.C. (202) 785-3050

Questions and Answers on Current Silver Statistics

1. **Is there a shortage of silver?**

There is no shortage of silver; however, there is an annual deficit in the amount of approximately 120 million ounces between U.S. new production of silver and U.S. consumption of the white metal. In the past, this gap has been filled by silver from secondary sources such as U.S. Treasury stocks, scrap recovery, other government stocks and demonetized coins. In the future, the gap is expected to be filled by silver from scrap material, imports and silver from demonetized coins, especially the 90% U.S. coins.

2. **How do the visible stocks for silver compare in 1977, 1978, and 1979?**

The visible stocks generally referred to are those certificated stocks in warehouses for the Commodity Exchange of NYC (COMEX), Chicago Board of Trade (CBOT), and London Metal Exchange (LME). In June of 1977, this total was some 159 million ounces. A year later it was 151 million ounces. As of June 30, 1979, the figure was 111 million ounces.

3. **What is the story on Indian silver?**

For many years, the citizens of India have accumulated large quantities of silver. Today estimates of this silver in the form of jewelry, religious items and decorations vary between four and five billion ounces. In the late 60's when silver reached $2.57 an ounce, silver from India reached the market at the rate of 60-80 million ounces per year. In the early 70's this rate was as low as 15-25 million ounces. In 1975, many observers estimated the supply from India was from 45 to 55 million ounces. For 1976, the figure was 63 million ounces; in 1977, it was estimated at about 30 million ounces, and for 1978, the figure is estimated at 25 million ounces.

4. **How much silver in 90% U.S. silver coins is estimated to be available to the market?**

Since our country's beginning, slightly more than two billion ounces have been consumed in coinage. During the final four years (1962-1965) of silver coinage more than 700 million ounces were used. The amount of silver available from this source is estimated at several hundreds of million ounces. Observers estimate that the rate of coin melting was between 20-25 million ounces in 1976. In 1977, that fell to about 13 million ounces. For 1978, the figure is estimated at 5 million ounces.

5. **What has been the recent history of silver usage in U.S. coins?**

By the Coinage Act of 1965, silver was removed as a coinage metal in all coins except the John F. Kennedy 40% silver half dollar which was minted through 1969 for circulation and through 1970 for special mint and proof sets. In 1971, the Mint began its production of 40% silver Eisenhower dollars for proof and uncirculated sets to be sold at a premium. In 1973, Congress directed the minting of 45-60 million 40% silver bicentennial coins (dollar, halves and quarters) to be made from silver set aside in the Treasury for the Eisenhower coin program. Minting kept to the lower figure of 45 million coins, consumed about 8 million ounces of silver, all furnished from Treasury stocks. So far, only half of the coins have been sold.

6. What would be the value of the silver in a 40% silver half dollar?

The bullion parity of the silver in 40% silver half dollars is approximately $3.38 per ounce of silver involved or, each $1,000 face value of 40% silver half dollars would contain 295 ounces of silver, allowing for wear. This compares with 715 ounces per $1,000 face value of 90% silver coins which have a bullion parity of $1.38 per ounce of silver involved. The 90% half dollar coin contains .36 of an ounce of silver while the 40% coin has .15 of an ounce each. The total amount of silver in the three-coin bicentennial set is slightly more than .55 of an ounce.

7. What has been the recent history of silver prices?

At the time the Treasury ceased selling silver to all comers in May, 1967, the price was $1.29 per ounce. While the U.S. Government sold silver to domestic users at $1.29, a two-tier price system existed with the world price reaching $1.78. In July, 1967, the Treasury withdrew from the market and a month later sales were resumed as a weekly auction through November 10, 1970. Prices rose to a high of $2.565 by June, 1968, and then began dropping until a low of $1.288 was recorded in November of 1971. The average price in 1972 was $1.68; $2.57 in 1973; and $4.71 in 1974.

A new all-time high was established at $6.70 on February 20, 1974. The strong upward pressure on the price was caused by a world-wide distrust of currencies and a speculative and investment craze. From August, 1975, until January, 1976, the price of silver had been in a downward trend, with an average of $4.42 in 1975 and $4.35 in 1976. Fluctuations between $4.30 and $4.96 during 1977 were wide at times, with 5-10 cent differentials not unusual from one day to the next. The average for that year was $4.62. The average price for 1978 was $5.40, with the high of $6.296 on October 30 and the low of $4.829 on January 5.

During the first half of 1979, silver prices were very volatile with a low of $5.961 per ounce and a record high of $8.768. As of June 30, the average for the year was $7.587.

8. Has anyone been successful in cornering the silver market?

We are aware of no efforts to corner the silver market. Since 1974 there have been rumors that one big investor held between 40-50 million ounces outright as well as forward contracts. Such a position represented a major portion of CBT and COMEX stocks. We believe the concentration of so much silver in the hands of one individual is contrary to the best interests of the users and consumers. This is the main reason for SUA's support of the efforts by the Commodity Futures Trading Commission to proscribe fuller disclosure in these markets and other requirements to prevent market manipulation.

9. Why is it necessary for silver futures to be regulated?

Silver futures trading needed to be regulated because the degree of self-regulation exercised by exchanges on which the metal traded was not sufficient to prevent attempts to manipulate the market and other fraudulent activities.

10. What do the consumption statistics reveal during 1978 - 1979?

Domestic industrial consumption in 1978 was estimated by the Bureau of Mines at 160.2 million ounces. This was a 4.3% increase from the figure for 1977, but still some 36 million ounces below the historic high of 196 million ounces in 1973. In the first quarter, 1979, consumption at 51.8 million ounces was at the highest level since the first quarter, 1974.

11. What is the silver import situation for the U.S.?

Because the U.S. is a net importer of silver, this metal contributes unfavorably to a deficit in the balance of payments. Should supplies be made available from government stocks, the need for imports would be reduced. At the average price of $5.40 per ounce for 1978, the cost of silver net imports was approximately $345 million. For every ten-cent increase in price, the cost for silver imported at the 1978 rate (64 million ounces) will be about an additional ~~$6.4~~ million.
53 $5.3

12. What is the importance of silver recovery, today?

Secondary silver is one of the most important factors in the silver market. In 1978, in the U.S. alone, scrap recovery including coins was estimated at 62 million ounces after being as high as 75 million ounces in 1974. For many years, scrap recovery has exceeded new production in the U.S.

13. What are the prospects for a substitute for silver in the photographic area?

Substitutions in the photographic area have already taken place with the best example being the office copying machines, most of which no longer use silver. Research efforts for other substitutes have been intensified but it is not foreseen that any major substitution will appear in the near future. In the x-ray sector, there is in limited use in hospitals, a silverless x-ray system. In this same area, the most interesting development is the introduction of microfilm recording of x-rays to permit immediate recycling of the silver and the one-time recapture of the large quantities of silver in the eight or ten year supply of medical x-ray film stored in hospitals and clinics around the country. The latter has been estimated at 100 million ounces. In the graphic arts area, laser techniques are being used to replace photographic reproduction in some printing.

14. What is the position of the Silver Users Association regarding stockpile legislation?

The members of the Silver Users Association support legislation which would authorize the disposal of all or any portion of the 139.5 million ounces of silver previously declared surplus to defense requirements.

15. What is the SUA rationale for its stockpile position?

Rationale for the SUA position supporting legislation which calls for the release of surplus silver from the stockpile may be summarized as follows:

- By National Security Council criteria, 139.5 million ounces of silver have been declared surplus to defense needs.
- With the high current market price for silver, the sale of government silver would mean increased revenue to the Treasury, benefiting all taxpayers and could reduce the budget deficit.
- Government silver made available to the market would meet a portion of domestic requirements and should lessen the need for imports.
- Additional supplies to the market of usable metal would be in the best interest of millions of Americans who consume products using silver - photographic, electrical, silverware, and medical and dental supplies.
- Finally, funds available from the sale of surplus silver could be used to purchase high priority items needed for the stockpile.

16. What is the opposition to the disposal of silver through GSA?

Opposition to the disposal of silver surplus to defense needs has been expressed by the domestic producers of silver as a part of their general opposition to the release of stockpile materials. During the consideration of copper stockpile releases in 1973, many of these same producers offered no objections to disposing of all copper in the stockpile, a metal as much or more important to defense needs as silver. Speculators and investors looking to the further appreciation of silver values also object to a release of silver from the stockpile. Some members of Congress have expressed concern over the proposed release, arguing that the precious metal should be retained for future, but unspecified or unjustified needs.

17. What is the background of the present silver stockpile?

Silver was first placed in the strategic stockpile in June, 1968, when 165 million ounces were transferred from the Treasury in accordance with the Silver Certificate Adjustment Act of 1967. By the Bank Holding Company Act of 1970, 25.5 million ounces were transferred from the Treasury for use in the Eisenhower coin program. The stockpile currently contains 139.5 million ounces.

18. What is an appropriate size of an emergency stockpile?

The National Security Council has determined that there is no requirement for silver in the stockpile. The United States, Canada and Mexico together produce about 131 million ounces of silver. When one considers that the rest of the Western Hemisphere supplies an additional 50 million ounces for about 180 million ounces against an annual demand of 160 million ounces in the U.S., it is evident that this raw material would be accesible in an emergency. The Comptroller General of the U.S. has confirmed the zero stockpile goal and methodology used by the Federal Preparedness Agency in determining goals.

19. Besides the stockpile silver, what other domestic above-ground supplies could be used to meet an emergency?

In addition to the government stockpile, other above-ground silver includes:

- 39 million ounces in the Treasury stocks for coinage
- 33 million ounces held by industry
- 6 million ounces in Defense Department stocks for contracts with government furnished material provisions
- 110 million ounces in COMEX and Chicago Board of Trade warehouses
- An estimated 250-900 million ounces in 90% U.S. silver coins held by citizens
- An undetermined amount of silver in ingots held as investments by citizens.

20. How much does it cost for the government to hold the 139.5 million ounces of silver which has been declared surplus?

At the current high interest rates, the equivalent cost of holding silver now valued at more than 1.2 billion dollars would be about $120 million per year or about $330,000 per day. In addition to the interest costs, about two percent of the silver's value (or $20 million) is needed to maintain the metal in the stockpile annually.

21. Is any silver required for the MX missile system being developed by the Defense Department?

The silver required for the MX missile system appears to be negligible, limited only to the usage for electrical contacts and missile parts. Although silver was originally considered for use in the batteries for the ground control system, "alternate technologies are being pursued due to the high cost and limited availability of silver", according to the Office of Defense Research and Engineering.

22. What effect would a disposal of 139.5 million ounces of silver have on the market?

Disposal of the 139.5 million ounces of silver surplus to defense needs at a rate of up to one million ounces per week at the market price should help provide stability to silver trading. This action, in turn, should make the market price more responsive to industrial supply and demand factors since there should be a reduction in wild speculation. When the government sold silver in 1967, prices continued to rise during the first nine months of the sales. During the next two years, prices were volatile ranging from a high of $2.56 per ounce to a low of $1.54 in 1969, and ending at $1.81 on the day of the last government sale in 1970. Within a year of the end of government sales, the world price returned to $1.29 before starting up again.

23. What would be the benefits to the economy from the government silver disposal?

With the disposal of government silver and the expected accompanying damper to the speculative fever affecting silver, consumers should be able to obtain articles using silver such as photographic products, electrical appliances, silverware and dental and medical supplies at more reasonable levels. Manufacturers of high silver content products could return to more normal marketing practices, and avoid any worsening of the employment picture. Revenue to the government would help reduce the budget deficits thus contributing to the fight against serious inflation. The balance of payments picture would be improved through lower silver imports.

24. At what rate should government silver be sold?

The rate of sale should be such as not to disrupt the silver market. As demonstrated by its handling of the 1967-1970 silver sales and the disposal of other commodities, the General Services Administration is capable of determining an appropriate release rate. At one million ounces per week, or half of the original rate of the previous sales, the government release would be about the same as imports at the 1978 level. A disposal at a smaller weekly rate should extend for a longer period the steadying influence over the market of this important silver source.

25. Would the use of silver in a coin be an appropriate alternative to GSA sales?

Silver has become too valuable for coinage. Because of the high price of silver, an appropriate alloy could not be adopted to mint a silver coin which would circulate. Using silver in a U.S. coin in the nature of a commemorative has already been tried in the 40% silver Eisenhower dollar and the bicentennial proof and uncirculated sets. The latter programs have failed to meet the expectations of their advocates.

26. Does the government purchase silver?

The government no longer purchases silver. The silver purchase acts were repealed in 1963; however, as a protection to the domestic producers of silver, the Coinage Act of 1965 requires that the government purchase domestically produced silver offered to it at $1.25 per ounce.

27. Is silver a good investment?

Silver, like any investment, performs well for the investor if it can be bought low and sold high. Unfortunately for the silver investor, this metal has been anything but stable in recent months. Another criteria for a good investment is liquidity. Despite many advertisements to the contrary, silver bullion is difficult to resell. One can obtain silver easily but when time comes for resale, the story is quite different. It is the old saying, "I can buy it; but to whom will I sell it?" The collateral value of silver bullion has also been exaggerated. Few bankers jump with joy when bullion is offered for collateral because there is the matter of purity and extreme price fluctuations.

28. What are the SUA views on the proposals for an economic stockpile of silver?

SUA does not support proposals for an economic stockpile of silver. The supply/demand situation for silver is not such that would require an economic stockpile. The open silver market is sufficiently diverse to provide the raw material for users as required. Any stockpiling needed should be left to the manufacturers concerned rather than be a function of government. Further, from past experience there is no evidence that the government possesses any particular expertise in determining the levels of such a stockpile or for devising the procedures for insuring such a stockpile would be responsive to the demands of the market. The forces of supply and demand seem adequate to govern the flow of silver to the market. Lastly, any such economic stockpile would require additional bureaucratic activity by the government without a noticeable benefit to the health, safety and welfare of the general public.

29. Where can I get more information about silver?

From the Silver Users Association, the Bureau of Mines and the Silver Institute, all in Washington, D.C. The various bullion dealers in New York City prepare silver summaries quite regularly. For 63 years, Handy & Harman has issued an annual silver review.

30. What has been the recent trend in futures trading in silver?

A study of silver futures trading during the last five years reveals that until recently, to have been a winner, one would have had to sell contracts rather than buy them. We went back a little more than five years as the speculative fever was then just starting to capture the silver market – the fall of 1973 when the spot price was $2.90. For the study, we assumed the purchase of one contract of 5,000 ounces on the COMEX as soon as it appeared on the board. The sale of each contract was assumed to take place the first day of the delivery month. The results of the study are on a chart attached to these questions and answers. In summary, though, while using the assumptions we mentioned, the figures show losses up to $40,000 for nearly four years. Only in the last two months of the period has there been shown a net gain, now up to $28,270. If anything is revealed by this informal study, it is that by the time all of the promotions and advertisements for getting rich quick are in the media, the train has already left the station. The remaining questions unanswered are, "Is there another train?"; "When is it coming through?; and lastly, "Should I get on?"

July, 1979

U. S. INDUSTRIAL CONSUMPTION

(Million of Ounces)

Category	1978	1977	1976	1975	1974	1973
Electroplated ware	7.2	6.8	9.5	8.7	13.2	14.5
Sterling ware	17.9	16.7	19.8	23.7	22.2	29.4
Jewelry	6.8	8.1	11.0	12.7	5.2	5.8
Photographic materials	64.3	53.7	55.5	46.1	49.6	52.0
Dental and Medical supplies	2.0	2.2	1.9	1.5	2.4	3.0
Mirrors	1.9	2.1	4.6	3.1	3.9	2.6
Brazing Alloys and solders	10.3	12.4	11.2	13.6	14.5	17.7
Electrical and electronic products:						
Batteries	6.0	5.8	3.5	4.3	6.2	4.2
Contact and conductors	30.7	31.3	32.3	27.2	31.3	40.2
Bearings	.4	.5	.3	.5	.4	.4
Catalysts	8.2	8.9	12.3	8.8	7.3	6.0
Coins, Medallions and Commemorative objects	2.7	4.3	8.2	7.2	22.3	20.1
Miscellaneous	1.0	.9	.3	.3	.5	.5
*TOTAL	199.4	153.6	170.6	157.7	177.0	196.4

*Totals may vary due to rounding off

Source: Bureau of Mines

Attachment 1

A Study of Silver Futures Trades 1973 - 1979

(5,000 oz. per contract)

Contract	Bought		Sold		Profit		Loss	
	Date	Amount Per oz.	Date	Amount per oz.	Per Ounce	Per Contract	Per Ounce	Per Contract
1975								
March	10/30/73	$3.068	3/3/75	$4.486	$1.418	$7,090		
May	12/31/73	3.451	5/1/75	4.336	.885	4,425		
July	2/27/74	6.292	7/1/75	4.556			$1.736	$8,680
September	4/29/74	6.138	9/2/75	4.367			1.771	8,855
December	7/30/74	5.550	12/1/75	4.063			1.487	7,435
1976								
January	8/30/74	4.738	1/2/76	4.230			.508	2,540
March	10/30/74	5.352	3/1/76	4.162			1.190	5,950
May	12/30/74	5.158	5/3/76	4.398			.760	3,800
July	2/28/75	4.940	7/1/76	5.001	.061	305		
September	5/1/75	4.800	9/1/76	4.267			.533	2,665
December	7/30/75	5.653	12/1/76	4.328			1.325	6,625
1977								
January	8/28/75	5.303	1/26/77	4.565			.738	3,790
March	10/30/75	4.746	3/28/77	4.781	.035	175		
May	1/13/76	4.548	5/25/77	4.552	.004	20		
July	3/2/76	4.560	7/26/77	4.597	.037	185		
September	4/30/76	4.896	9/27/77	4.605			.291	1,455
December	8/2/76	4.696	12/27/77	4.758	.062	310		
1978								
January	8/30/76	4.507	1/26/78	4.965	.458	2,290		
March	10/29/76	4.648	3/28/78	5.363	.715	3,575		
May	12/29/76	4.722	5/25/78	5.232	.510	2,550		
July	2/28/77	5.121	7/3/78	5.258	.137	685		
September	4/28/77	5.107	9/1/78	5.543	.436	2,180		
December	7/29/77	4.914	12/1/78	5.875	.961	4,805		
1979								
January	9/1/77	4.884	1/2/79	6.000	1.116	5,580		
March	9/15/77	4.953	3/1/79	7.750	2.797	13,985		
May	8/31/77	5.011	5/1/79	7.906	2.895	14,475		
July	8/31/77	5.068	7/2/79	8.554	3.486	17,430		
					Grand Total GAIN	$80,065		

Note: The highest number of contracts held at one time was eight with a deposit of about $1,200 each, for a minimum investment of $9,600 at any time, not including margin calls.

$80,065	Grand Total GAIN
51,795	Grand Total LOSS
$28,270	Net Total GAIN

Attachment 2

October 16, 1979

THE
FIDELITY
BANK

[illegible] WALNUT STREETS
[illegible]
[illegible] 985-6000

Arab Investors Group, S.A.
14 Rue Aldringen
Luxembourg
Grand Duche du Luxembourg

Gentlemen,

This letter sets forth our understanding of the nature of the activities which have been and will continue to be performed by us in connection with your proposed investment in Sunshine Mining Company. It also discusses the compensation for our services.

The services we are performing include the introduction of principals of your Company (or their representatives) to Sunshine Mining Company, and acting as your financial adviser in connection with your proposed acquisition of up to 1,500,000 shares of Sunshine Mining Company. We will continue to act in such capacity until the earlier of your acquisition of the complete block of Sunshine stock or our receipt of notification from you that you no longer require our services in this connection. The acquisition will not be deemed complete until delivery of the appropriate stock certificates has been made to you or your representatives.

In consideration for our services, our fee will be 300,000 dollars (U.S.). Included in this fee, which is payable within a reasonable time after successful consummation of your purchase of at least 1,000,000 shares of Sunshine stock, are all our expenses in connection with the services we have and will have rendered. Such fee will be payable upon any transaction as herein described within twelve months from the date of this agreement. In the event you purchase less than 1,000,000 shares, the fee will be negotiable except as follows. If you only purchase 100,000 shares of Sunshine stock, our fee will be 50,000 dollars plus reimbursement for all reasonable expenses incurred in connection with this transaction. If no shares are purchased, our fee will be 15,000 dollars plus expenses as described.

In the event of any claim, action or proceeding arising out of or in connection with your proposed investment in Sunshine Mining Company, you will indemnify The Fidelity Bank, Robert E. Keith, Jr. and Robert N. Verratti from and against all costs, counsel fees, expenses and liabilit incurred in connection with any such claim, action, or proceeding. We shall be responsible for any fees payable to third parties who have assisted us in this transaction.

In connection with our role as financial advisor, we have received various information and written material from other parties, specifically including the Sunshine Mining Company and Behre Dolbear. Although we have evaluated this information and offered opinions about it to you, we are not responsible for its accuracy.

Kindly indicate your agreement with the matters set out in this letter by having an authorized representative sign and date one copy of this letter in the place indicated below and return it to my attention at The Fidelity Bank at your earliest convenience.

Very truly yours,

Robert E. Keith Jr.

Robert E. Keith, Jr.
Vice President

I hereby accept and agree to the terms and conditions outlined above.

Arab Investors Group, S.A.

By: Attorney in Fact

Date: October 26 1979

17

THE
FIDELITY
BANK

& Walnut Streets
[illegible] Penna. [illegible]
[illegible]

ARAB INVESTORS GROUP S.A.
14 Rue Aldringen
Luxembourg.

5th December 1979

Attention Mr. Joseph A. El-Khoury, President

Gentlemen,

The Fidelity Bank, London Branch, is pleased to confirm to you the following commitment subject to the terms and conditions outlined below and subject to final documentation inform and substance satisfactory to the Fidelity Bank. This letter supercedes our letter dated October 16, 1979.

Purpose: To finance the purchase from Sunshine Holdings and/or Sunshine Mining Company of a minimum of 1,029,800 shares of common stock of Sunshine Mining Company.

Commitment Amount:

A) An amount equal to 50% of the agregate purchase price but in no event more than US Dollars 10,941,625

B) Letter of credit facility in favour of Sunshine Holdings Corporation in an amount not to exceed US Dollars 21,883,250. Said letter of credit will be in the form of exhibit 'A' attached hereto, will have an expiration date of not more than thirty (30) days from the date of issuance and will be issued upon our receipt of your deposit in an amount equal to the lesser of 50% of the letter of credit or US Dollars 10,941,625.

../2

Term and Repayment:

The loan will have a term of six years from the date of borrowing and will be repayable as follows:

A) Years one, two and three interest only.

B) Year four - 20% reduction of original principal balance.

C) Year five - 30% reduction of original principal balance.

D) Year Six - 50% reduction of original principal balance.

All principal payments will be payable in quarterly installments equal or substantially equal to 25% of the principal reduction required in the respective years during the term.

Borrowing Rate:

One and five eights percent in excess of the one, three or six month Libor rate to be determined at our option. Interest will be payable quarterly commencing three months subsequent to the borrowing.

Availability:

Closing and takedown on or before January 10, 1980.

Assignability:

This commitment may be assigned to Clematis, N.V. provided that Arab Investors Group (AIG) unconditionally guarantees both principal and interest due and outstanding under the loan agreement.

Prepayemnt:

Optional and without penalty in increments of not less than US Dollars 500,000.00.

Collateral:

At the time of closing under this commitment we will receive a pledge of all shares of common stock of Sunshine Holdings and/or Sunshine Mining having a current market value of not less than 200% of the principal balance of the loan. You will obtain and assign registration rights for all such shares.

Currency:

Subject to availability borrowings hereunder may be in Deutsche Marks or Swiss Francs.

Events of Default:

The usual and including without limitation, the following:

Failure of AIG to comply with both affirmative and negative financial covenants to be determined by us or a material adverse change in the financial condition of the AIG which in our sole opinion substantially increases the risk that the loan will not be repaid when due.

Miscellaneous:

A) The stock purchase agreements shall be in form and substance satisfactory to us and shall be approved by our counsel.

B) The per share cost of Sunshine Mining Company stock shall in no event be greater than Dollars 21.25.

C) In the event of an assignment of this commitment, AIG shall have the option of providing replacement guarantor(s) provided that any such replacement is acceptable to us in our discretion.

D) The making of this loan and the transactions contemplated hereby shall not violate any public law, statute rule or regulation of the Securities Exchange Commission or the Federal Reserve Board (including but not limited to regulation U) nor shall it violate the Corporate Charter or By-Laws of Sunshine Mining Company and of Sunshine Holding Corp.

We hope that the financing proposal meets with your approva

Please indicate your acceptance of this commitment by executing and returning the attached copy to the undersigned

Very truly yours,

Jean-Pierre Galy, Vice President

Accepted for the borrower-Arab Investors Group S.A.

ARAB INVESTORS GROUP S.A.

Directors and Executive Officers

Name	Residence or Business Address	Citizenship	Position with AIG	Principal Occupation or Employment, and Name, Principal Business and Address of Employer
Joseph A. EL-KHOURY	Imm.Shammas Rue Sursock-Beirut LEBANON	Lebanese	Chairman-Managing Director	Chairman-Managing Director .Banque de la Mediterranee S.A.L. (Beirut, Lebanon) .Banque de la Mediterranee-France S.A. (Paris-FRANCE) .Banque d'Affaires Franco-Arabe S.A. (Paris-FRANCE)
LDI S.A. Holding	23, rue Beaumont Luxembourg - Grand Duche du Luxembourg	Luxembourg	Director	Holding Company
Mr. H. Sheikha Badriah - Saud AL-SABAH	Al-Salmiyah Palace Kuwait	Kuwaiti	Director	Member of the Ruling Family Chairman/ UNITED TRADING GROUP - Kuwait
Mr. ABU KHADRA	Airport Street Ryadh/S. Arabia	Saudi	Director	Self-employed contractor and industrialist, owner of ORBIT MECHANICAL GROUP Ryadh - Saudi Arabia
Mr. Mikati	Mikati Bld.Tripoli	Lebanese	Director	Self-employed Contractor Co-Owner of Arabian Construction Corp.-Abu Dhabi United Arab Emirates
Mr. NACHEF	Nachef Bldg.Gazalieh Street -Beirut/ Lebanon	Lebanese	Director	Self-employed businessman Gazalieh Street-Beirut Lebanon.

G. Michael Boswell, President and a director of the Company, is the sole owner of the Commodity and Raw Materials Group, Ltd. ("CRM"). During the year ended December 31, 1978, CRM entered into a Consulting Services Agreement with J. H. Rayner (Holdings) Limited ("Rayner") and its parent, The First Arabian Corporation ("First Arabian"). Mr. Boswell also entered into a Personal Services and Consulting Agreement with Rayner and First Arabian. On December 3, 1978, Mr. Boswell made the following offer to the Company:

(1) that the Company consider whether it might wish to purchase CRM (together with the Consulting Services Agreement) at Mr. Boswell's cost;

(2) that, in the event that the Company elects to purchase CRM, that Mr. Boswell assign to the Company the Personal Services and Option Agreement;

(3) that, in the event that the Company elects not to purchase CRM, that Mr. Boswell reimburse the Company at the rate of 1/22 of his monthly compensation for each business day that he devotes to the affairs of CRM or the Personal Services and Option Agreement.

The board of directors referred the matter for decision to the Compensation Committee. No decision has yet been made by the Compensation Committee with respect to Mr. Boswell's offer to sell CRM.

10-K

THE ARAB DEAL
M. Boswell's
SILENT PARTNERS

THE WALL STREET JOURNAL, Wednesday, December 12, 1979

Sunshine Mining Sells 19% Stake To Arab Group

Holding Could Be Extended To 27%; Rival Investor In U.S. Voices Complaint

By a WALL STREET JOURNAL Staff Reporter

NEW YORK – Dallas-based Sunshine Mining Co. announced the sale of more than one million shares of its common to a group of Arab investors in a transaction that stirred an immediate complaint from a rival investor here.

Sunshine said that the 1,030,000 shares of its stock held by Sunshine Holdings Corp., which was formed only last June, will be sold to Arab Investors Group S.A., a Luxembourg corporation, for $21.25 a share, or an indicated total of $21.9 million.

In addition, Sunshine said it granted Arab Investors Group an option to buy 500,000 of its common shares held in Sunshine Mining's treasury—also at $21.25 a share, or an aggregate $10.6 million. The option will expire at the end of next month.

There has been a recent swirl of rumors that, with silver and gold prices soaring, individual Arab investors are turning more and more to investments in precious metals and away from currency-tied investments. The proposed investment in Sunshine, a major U.S. silver producer, would seem to confirm some of these rumors.

The investment, which is believed to be the first nonbanking investment by Arab Investors Group, stirred an immediate complaint from Andrew G. Racz, president of the Racz International division of Phillips, Appel & Walden Inc., a New York-based securities firm.

Mr. Racz called The Wall Street Journal yesterday afternoon to complain that he had lined up an offer for the 1,030,000 Sunshine shares, and that Sunshine had accepted the offer in a telegram.

Silver Mine

Mr. Racz complained that the 19% holding in Sunshine, which is expandable to an about 27% holding under the option agreement, would give Arab Investors Group virtual control of Sunshine Mining, which operates and has a 69% interest in the nation's biggest silver mine.

"Silver is a national asset. As an American citizen I protest handing Sunshine's potential 174 million ounces of silver reserves over to unnamed Arabs," Mr. Racz said. "Let us make no mistake about it, we are in a monetary war" with the oil-rich Arab nations, he added.

Sunshine Mining President G. Michael Boswell denied that the company had accepted any offer by Mr. Racz or investors associated with him. He did confirm that Sunshine sent a telegram to Mr. Racz "that said that if he were to bring us the buyer for the shares, we would agree to pay him a fee equal to the brokerage commission on the one million shares up to a limit of $200,000," Mr. Boswell said.

Mr. Boswell said that "Mr. Racz came to see me in my office on Nov. 19 and I spent about two hours giving him the standard briefing we give potential investors, including that we were working on placing the shares of Sunshine we bought back from the Hunt brothers in last summer's settlement of our dispute with them."

(Nelson Bunker Hunt and William Herbert Hunt of Dallas had acquired a 29% interest in Sunshine as part of an aborted takeover attempt, which was settled last summer when Sunshine bought back the stock.)

Placement Negotiations

Mr. Boswell said: "At Mr. Racz's request, I went to see a Mr. Martin Sosnoff of Atlanta Capital Corp. and he expressed an interest in the block. I told him we had been involved in negotiation of such a placement for six months, but if that transaction weren't consummated, I would be glad to talk to him further on the matter."

Arab Investors Groups is owned by a combine of some two dozen individual Arab investors, mostly Saudi Arabians and Kuwaitis, Mr. Boswell said. He added that the company's investments include a 100% holding of Paris-based Banque de Affaires Franco-Arabes S.A.; a 67% interest in Banque de la Mediterranee-France, also based in Paris; 64% of Banque de la Mediterranee S.A.L., Beirut; 89% of Financiere Mediterranee Baffa Finebaf S.A., Switzerland, and 19% of Banque Ivoirienne de Construction et des Travaux Publics S.A. Ivory Coast, Africa.

Mr. Boswell said that noted Arab investor Roger Tamraz wasn't a part of the group, "although he knows some of the people and he holds 100,000 Sunshine shares himself."

The Sunshine executive added that agreements to be released in the proxy material to be filed for the proposed transaction include "standstill provisions" to insure that the investors' wishes and our wish that they not exercise working control of Sunshine are realized."

PHILIPS, APPEL & WALDEN, INC. 111 Broadway, N. Y., N. Y. 10006 (212) 964 9000

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December 14, 1979

The Honorable Congressman Henry Reuss
2413 Rayburn Bldg.
Washington, D.C. 20515

Dear Congressman:

It is my considered opinion that there is an effective danger of the American silver industry flowing into unregulated foreign hands - a step that could form a threat to the monetary stability of the United States of America.

Such control is now being initiated by Sunshine Mining Company selling 19% interest to Arab Investors Group, S.A., a Luxembourg corporation, a group whose owners are not yet defined. Sunshine has also granted option to buy an additional 8% ownership before January 31, 1980. In total, 1,529,800 shares will be passed to Arab Investors Group, S.A. at a price of $21.25 per share. Thus, for a total sum of less than $35 million, the largest American silver company will be controlled by an offshore group. Mr. Michael Boswell has stated that there is a standstill agreement which gives Arab investors no degree of control over management and limits their stock-buying options for several years. I wonder whether a Congressional Committee, if appointed, could classify the purchase As passive banking investors.

May I bring the following facts to your attention. The silver shortage today is a well-known phenomenon and skyrocketing gold and silver prices form a direct and indirect threat to the stability of the currency markets and, in particular, to the dollar.

The entire American silver production was 38 million ounces in 1978. Sunshine controls 60% of the nation's largest silver mine which produced 5 million ounces in 1979 and estimated to produce 7 million by 1982 and 9 million in 1984.

Sunshine has publicly stated that it is seeking financing to expand its mining efforts through acquisitions in existing developing properties. Accordingly, the danger exists that a larger and larger percentage of American silver reserves will be under the corporate umbrella of Sunshine

The Honorable Congressman Henry Reuss

(Continued)

and, through its 27% ownership of Sunshine, under the control of Arab Investors Group, S.A.

May I now refer to a quotation written by another brokerage firm which was handed to me by Mr. Boswell at our meeting on November 18th and 19th in Dallas, Texas.

"ORE RESERVES VALUED AT OVER $1.5 BILLION

In May 1979, Sunshine had the highly respected mining consulting firm of Behre Dolbear & Co. Inc. prepare an updated report on ore reserves. The report estimated total ore reserves above the 6,000-foot level at 6,477,000 tons, containing about 171.8 million troy ounces of silver. These reserves are comprised of 1,494,000 tons of developed and probable reserves containing about 47 million ounces of silver and 4,983,000 tons of "possible" (or "postulated") ore, containing about 125 million ounces. Although Sunshine's percentage of ownership varies from area to area, overall the company's share of reserves is estimated at approximately 3,551,000 tons of ore, containing an estimated 94 million ounces of silver. With silver at $16 an ounce, the gross value of Sunshine's ore reserves is over $1.5 billion. The "possible" or "postulated" reserves are more speculative than either the "proven" or "probable" categories and are based upon scantier physical evidence, such as drill holes and geologic inference rather than by determination of mine workings. Although more speculative, "possible" ore reserves are valid, especially so for a mine such as the Sunshine, which has continued to produce for more than 70 years."

As the enclosed article from Executive Intelligence Review indicates, it was also rumored in London that Sunshine Mining was arranging a highly unusual silver-indexed $300 million private placement with unidentified investors in London. The article states that "there is an interest known in the trade as the silver cartel".

Any commodity trader could confirm, Mr. Congressman, that when the ownership of 20% - 30% of American silver, whose value at today's market prices is well over half a billion dollars and probably much higher, it is a sufficient base to dominate the International Silver Industry.

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The Honorable Congressman Henry Reuss

(Continued)

It is my considered opinion that the Congress of the United States should immediately issue an injunction or at least investigate the proposed transaction.

The common stock of Sunshine is selling today at $25., 20% higher than the price offered to Arab Investors Group, S.A. I have no doubt that, given sufficient time, the most reliable passive American investors could be found to purchase this control block and keep the American Silver Industry in American hands.

I think Mr. Boswell is somewhat mistaken when he stated "maybe it is regrettable that the Arabs were the first to come forward, but I think it is a sad commentary on the lack of aggressiveness by U.S. business".

This statement, Mr. Congressman, is mistaken, misleading and I trust will be proven by Wall Street that it is totally false. Let there be no mistake about it that when the total U.S. strategic silver stockpile is under 139.5 million ounces and when Sunshine's current reserves are 171 million ounces, Congress, by not acting, may be presiding over the transfer of the U.S. Silver Industry to Arab Investors Group, S.A. of Luxembourg.

As a Security Analyst who testified on other occasions before Congress, I state that purchase of the said shares would not be difficult to find with American investors.

As an American citizen, I appeal to Congress to take up this matter as there is more than reasonable doubt that failure to act is a further step to surrendering the monetary integrity of the United States of America.

Kindest regards.

Sincerely yours,

Andrew G. Racz

AGR/raa

Business Briefs

Corporate Strategy

Chrysler selling foreign branch

Chrysler Financial Corp. is currently negotiating the sale of a 75 percent interest in Chrysler Credit Australia, Ltd. to an Australian subsidiary of the Barclays Group. The $10 million sale is the latest in a series of overseas divestitures made by the troubled U.S. corporation to raise cash and pare operations.

Meanwhile, bargaining and compromise on federal loan guarantees for Chrysler continues on Capitol Hill. The latest plan is a compromise proposal jointly sponsored by Sen. Paul Tsongas and Rep. William Moorhead which eliminates the three-year wage freeze for Chrysler workers that was specified in the Senate bill. The plan includes $600 in wage and salary concessions from Chrysler employees, a $100 million advance loan from the UAW, and the creation of a $60 million Employee Stock Ownership Program. In addition, a government review board would be established to oversee the corporation, similar to the Emergency Financial Control Board for New York City. The board would consist of the Secretaries of Treasury, Labor, and Transportation, plus Fed Chairman Volcker and John Heimann, the Comptroller of the Currency.

Commodities

Hunt-Saudi silver grab

The Hunt family and a group of Arab investors have sealed a deal which will permit them to jointly establish a "corner" on world silver production, according to informed market sources. On Dec. 11, Sunshine Mining Co., a Dallas-based silver mining firm (in which the descendants of Texas billionaire H.L. Hunt have a large interest), announced the sale of more than one million shares of its stock—a 19 percent stake—to the Luxembourg-based Arab Investors Group. The Arab Investors Group is reportedly closely tied to Roger Tamraz, a leading Saudi financier who holds an additional 160,000 Sunshine shares.

Sunshine's general counsel Samuel Dash reportedly "gave the final okay" for the Sunshine-Arab Investors deal. Dash, who played a prominent role in the Watergate investigations, also heads the Jesuit Georgetown University's Law Center.

Sunshine Mining will produce 5.5 million ounces of silver this year out of a total U.S. output of 43 million ounces and reportedly controls 20 percent of U.S. silver reserves. Sunshine is also issuing silver-indexed bonds in private placements in London, the proceeds of which the company plans to use to buy up other silver mines in the U.S. and Canada.

Virtually the entirety of world silver output is concentrated in only four countries: Mexico, Peru, Canada, and the U.S. Silver, which is used in the production of batteries and film, is already in tight supply, with world consumption this year surpassing newly-mined supplies by about 100 million ounces.

Sunshine's deal with Arab Investors is being hotly contested by Andrew G. Racz, president of the New York-based brokerage firm Racz International, who had hoped to purchase the shares on behalf of an unidentified group of American investors. Asked whether the Sunshine deal might have anything to do with the reported disappearance of reserves held by the Saudi Arabian Monetary Agency (SAMA), Racz replied: "Of course, there's a connection. This is how the Arabs got the money."

According to recent reports, several Hunt family members involved with Sunshine were interviewed by the U.S. Commodity Futures Trading Commission in connection with CFTC's investigation of a silver market squeeze a few months ago. At that time British and Swiss bullion interests joined forces with a group of Kuwaiti investors and the Hunts to create an artificial silver shortage. Many small American investors were caught short, provoking the commodity regulatory authorities to investigate.

Hunt family silver holdings are rumored to have amounted at one point to more than seventy-five percent of all outstanding American futures contracts. As part of its investigation the CFTC filed a complaint Dec. 3 against a Swiss bank, Bank Populaire Suisse, which had refused to name the clients for whom it had placed large orders for silver futures.

Although this "silver cartel" has placed primary emphasis on silver, market experts say that Swiss banks are also behind the latest gold price run-up above the $400 level, often placing their orders on the highly anonymous Hong Kong market.

One analysis of what the "cartel" is up to says that it is coordinating its activity with the Bank of England, which wishes to discredit Franco-German efforts to build a gold-based monetary system by creating excessive volatility on world gold markets, and focusing attention on silver at gold's expense. The British central bank also hopes to terminate the U.S. dollar's reserve currency role, replacing it with a currency system indexed to the price of strategically important metals and raw materials.

International Credit

Kuwait, Libya form joint bank

Kuwait and Libya have agreed to form a bank with $1 billion in resources, the Kuwaiti News Agency reported on Dec.

Monday, December 31, 1979 OKLAHOMA CITY TIMES

Possible bullion cartel spells danger for dollar

By Johannes Steel

There are some telltale signs that an international silver cartel on the model of the OPEC cartel is in the making.

The consequences of such a development could be as sinister for the U.S. dollar as the formation of the OPEC oil cartel was on the value of our currency during the past four years. It could further destabilize the already fragile monetary structure of the world.

Unidentified Arab elements have brought 1.5 million shares of Sunshine Mining (and have an option on another half a million shares) at $21.25, which was certainly cheap to begin with, since Sunshine is the greatest silver producer in the United States.

ON WALL STREET

But apparently another bid from American sources was made at about the same time of $22.25 for the second block, which amounts to 27 percent of Sunshine's outstanding shares.

This bid was managed by Andrew G. Racz, a highly regarded commodity trader who heads Racz International, a division of the New York brokerage house of Phillips, Appel & Walden.

Meanwhile, Sunshine Mining has let it be known that it plans to raise $250 million in Euro-dollars indexed to the CURRENT price of silver.

In other words, the lender would be paid back in silver bullion or silver coins at TODAY'S prices regardless of where silver is priced when the low-interest loans become due.

This entire process could be highly destructive to the world monetary system and could, in effect, become the first step towards a worldwide barter system that could play havoc with international trade.

Racz has expressed the view in congressional circles that Sunshine Mining, with its 171-million ounce silver reserves and its potential 27 percent ownership by as yet unnamed Arab investors, is basically a dangerous vehicle, which, through its full development, could lead an actual attack on the stability of the monetary structure of Western civilizaiton.

Racz's point is that is Sunshine succeeds in raising the proposed $250-million private silver-backed financing through the Euro-dollar market, it would represent the disappearance of some 15 million ounces of silver - equal to 15 percent of the total annual American shortfall from the marketplace.

The United States has an annual silver deficit of 90 million ounces, and its total production is only some 42 million ounces. But we consume around 150 million ounces per year.

Canada produces 40 million ounces, Mexico 56 million ounces, and Peru 44 million ounces per year. This means that we are looking at a situation in which we can become as dependent on Mexico and Peru for silver as we are now on the Mideast and African oil producers. Incidentally, Russia has a shortfall of 90 million ounces of silver annually.

If Sunshine succeeds in selling only $100 million in Euro-bonds with silver backing at current prices, they would have to take five million ounces out of the market. A $200-million loan backed by silver means that 10 million ounces would have to be taken out of the market; $300 million would increase that to 15 million ounces.

That would represent 30 percent of America's annual silver production.

Obviously, if Sunshine succeeds with that silver-indexed loan, many other international operators would follow its example.

The one-trillion dollar Euro-currency market could turn into a gold and silver-indexed paradise for those speculators and into a veritable hell for anyone who wants to trade in U.S. dollars, or any western European currency for that matter.

Sunshine Mining's president is putting all of his eggs in one basket. A silver basket.

Michael Boswell and his Arab friends

By Michael Kolbenschlag

The Sunshine Mining Co. is best known for the giant silver mine of the same name it operates in the Coeur d'Alene district of northern Idaho. In recent years, however, the Dallas-based company has gained half of its income and as much as 75% of its revenues from other operations like fencemaking, electronics and oil and gas.

All that changed last year when the price of silver soared to $27 an ounce, more than four times its price in 1978. Sunshine's estimated earnings quadrupled with the higher price of silver, rising to $13 million, or $2 per share, on revenues of $75 million.

A one-shot performance? If silver remains at these lofty levels or soars above them, it will be breaking all precedent, but G. Michael Boswell, Sunshine's 39-year-old president, insists that 1979 was not a fluke. He is liquidating all of Sunshine's nonsilver-related manufacturing operations and is planning to expand further into silver, using Arab petrodollars plus money raised through the sale of unique silver-backed securities. The result, says Boswell, "will be a vertically integrated metals firm devoted solely to silver."

Since 1918, when the company was founded, Sunshine and its partners, the Hecla Mining Co. and Silver Dollar Mining Co., have extracted over 300 million ounces of silver from the Sunshine mine—of which Sunshine owns 57%, Hecla 33% and Silver Dollar 10%. Boswell, who took over the $130,000-a-year (plus bonus) Sunshine presidency in 1977, says that "management in the past just plain ignored the basic asset of the company. They didn't put the kind of manpower or investment into the mine that was needed."

Since taking office, Boswell has done just that, plowing $12 million into capital improvements since 1978, with another $20 million scheduled for investment in the early 1980s. This, he says, is only the beginning. The Sunshine mine produced about 5 million ounces of silver last year. Boswell predicts, "It will be producing 7 million ounces by 1983 and in excess of 9 million ounces by 1985." However, Boswell says he can see silver rising substantially higher in the decade that has just started. Putting his money where his mouth is, Boswell plans to purchase additional silver-producing properties while anticipating production at a Nevada mine in which Sunshine has a two-thirds interest. "If our plans work out, we'll be getting as much silver from the other properties as we'll be getting from Sunshine," he says. If that happens, that would give Boswell 18 million ounces a year, worth $486 million at current prices.

To get that production he talks of in-

Sunshine Mining President G. Michael Boswell

Getting out of distractions like manufacturing to bet everything on silver.

Reprinted by permission of FORBES magazine from the January 21, 1980 issue.

vesting a staggering $300 million in new silver properties. Where is all that money coming from? Boswell is selling Sunshine's manufacturing subsidiaries—fencemaker Anchor Post Products Inc. and electronics firms Piezo Crystal and Premier Metal Products—to a newly formed company run by the former managers of these operations. He will raise $28 million from the sale. Beyond this, Boswell has some novel ideas. If his financial advisers can successfully negotiate their way through a morass of SEC and IRS regulations, he intends to sell either silver-backed securities or silver-backed debt issues to both U.S. and international investors.

He got his idea in part from the Mexican government, which has issued 1,000-peso bonds pegged to the price of oil, and the French government, which has indexed certain bonds to gold. (There are a number of U.S. railroad bonds issued in the 1880s whose redemption was promised in gold, but the promise was voided when the U.S. made gold holding illegal in the 1930s.) One of Boswell's securities could be a preferred stock that would pay a cash dividend of 5% or 6%. Sunshine would agree to redeem the stock at par value in terms of a fixed ratio of silver weight to value.

Shift change at Sunshine, the U.S.' largest silver mine, in Kellogg, Idaho

Will silver's quadrupled price in the last year keep soaring?

The alternative would be a bond. It would be redeemable—after five years, say—for a fixed amount of silver. With silver backing, Boswell thinks such a bond could carry an interest rate less than half the current prime lending rate. What the buyers would lose in interest they would gain in inflation protection—on the assumption, of course, that silver will continue to increase in price.

There are risks in all this, both for the investor and for Sunshine. If silver drops in price, the investor would be left holding a piece of paper with a low interest rate and of relatively low quality. *Could* silver drop in price if inflation continues? Of course, it could. What goes up also comes down, and silver went up last year. Remember what happened to gold back in 1976. It dropped from nearly $200 an ounce to $100 an ounce while inflation raged.

Yet another problem: Should runaway inflation develop, Sunshine's cost of production could increase to the point where it would be extremely burdensome to deliver the promised silver. On the other hand, should the price of silver rise as handsomely as Boswell thinks it will, the promise to deliver silver at a fixed price would penalize future profits.

Nevertheless, Sunshine's lawyers are currently deciding which of the two instruments is the more desirable and are devising an array of downside protections for both the company and the investor. Boswell hopes to launch the first $50 million of these instruments in 1980, possibly offering them first to his own shareholders and later to a wider domestic and international audience.

Boswell's mind clearly runs to the unorthodox deal. Last summer he horse-traded 160,000 shares or 3% of Sunshine's stock to Arab financier Roger Tamraz of the First Arabian Corp. for First Arabian's London-based commodities firm, J.H. Rayner (Holdings) Ltd. He is now restructuring Rayner so it can serve as his international bullion dealer.

Sunshine Mining is precisely the kind of investment that appeals to Arab oil money. It bothers the Arabs to exchange oil for depreciating paper dollars. By contrast, it makes sense to many of them, in effect, to swap their oil for other resources in the ground. Capitalizing on this, Boswell plans to place control of the company with an Arab group that will give him a free rein in running the company. Here's the story:

Boswell is a tall, native Texan, born near Dallas, schooled in finance and law at Southern Methodist University and fond of flamboyant speech, Swedish Tiger-brand three-piece suits and $300 Lucchese boots. He was originally put in charge of Sunshine by Nelson Bunker and William Herbert Hunt, the Dallas petromagnates who took the company over in a bloody 1977 tender offer, which left them with 28% of the 6 million shares of common stock. Last June, however, Boswell bought out the Hunt interests with money borrowed from the company when the tender offer stalled short of a full takeover. Now Boswell has sold the Hunt stock to the Luxembourg-based Arab Investor Group, which consists of Saudi and Kuwaiti private investors. Why Arabs? "Because," he replies, "we were looking for a very stable long-term equity investor who would not seek to control Sunshine but merely be satisfied to see his investment appreciate in a fashion that we've outlined to him in advance." Looking pleased with himself, Boswell calls the Arabs "silent partners."

Boswell has gotten some flak for the Arab deal from Andrew G. Racz, president of Racz International division of the New York securities firm Philips, Appel & Walden, Inc. A minority investor in Sunshine, a metals analyst and a bull on silver, Racz gives Boswell high marks for putting Sunshine Mining on the road to becoming the only totally integrated silver company in the U.S. But he flunks Boswell for concluding his deal with the Arabs in only two days with little or no dickering while both the price of silver and the price of Sunshine stock were climbing dramatically. He is particularly miffed that Boswell turned down his offer on behalf of U.S. investors that was $1 per share higher than the Arabs' deal. "For $33 million Boswell is handing over the American silver market to the Arabs," he gripes. Racz is appealing to influential congressmen to stop the deal. But Boswell considers the matter closed: "It's a little unfortunate that the gentleman had to take an adverse position in this transaction," he says in an unusual moment of understatement.

Mike Boswell clearly has giant ambitions. Can he fulfill them? That question can only be answered with another question: What's going to happen to the price of silver? We're not brash enough to answer that one. ■

The New York Times TUESDAY, FEBRUARY 5, 1980

Sunshine Planning Sale Of Silver-Backed Notes

By ROBERT J. COLE

The Sunshine Mining Company, the nation's largest silver producer, said yesterday that it planned to raise $50 million to expand operations by selling $1,000 certificates redeemable into either cash or silver.

The interest-bearing certificates, to be traded on the New York and Pacific Stock Exchanges in much the same way as bonds, will be the first silver-backed obligations of any kind since the United States withdrew silver backing on paper currency in 1963.

They will be offered publicly in about a month through a Wall Street investment syndicate to be managed by Drexel Burnham Lambert Inc.

Andrew G. Racz, an authority on silver and president of Racz International, New York, called the move "the historical turning point in legitimizing gold and silver as backing for currency."

As proposed by Sunshine, investors would be unable to collect silver for their certificates for at least the first five years. After that, at Sunshine's option, investors would receive either silver, its value in cash at that time or the $1,000 face value, whichever is greater.

The company, announcing it had filed papers for the offering with the Securities and Exchange Commission, said the certificates would become due March 1, 1995

"The principal amount of each certificate whenever due shall be the greater of $1,000 or the price of a certain number of troy ounces of silver bullion," the company said in a statement. They would be freely negotiable in the meantime, however. The amount of silver to be offered and the interest rate to be paid — both of which depend on market forces — will not be made public until shortly before the offering.

One well-placed Wall Street source asserted that the importance given silver as an inflation hedge would help set the interest rate Sunshine will pay. He maintained that the rate might be substantially less than Sunshine would normally pay to raise funds.

As for the amount of silver backing, this source explained that, if silver sold for, say, $40 an ounce at the time of the offering, $1,000 worth would mean Sunshine might back the certificate by 25 ounces. But, he said, Sunshine might decide to back it by only 20 ounces, which, in turn, would mean that the company expected to pay a higher interest rate.

Silver bullion stood at $6 an ounce at the start of 1979 and soared as high as $50 an ounce in the middle of last month. As measured by the February futures contract, silver closed yesterday at $33 an ounce.

Sunshine's novel offering — the first of many expected to be made by other companies with large silver holdings if this one is successful — emerged in London last month after company officers told investment analysts there that they envisioned issuing as much as $300 million in silver certificates to finance expansion. Industry sources seriously doubted whether Sunshine would later offer more than the present $50 million.

Explaining how the new certificate appeared to him, Paul Sarnoff, New York commodities research director for Conti Commodity Services, said: "You've got yourself a way of investing in silver. You're getting a return on your money, and you have a chance for growth with the rise in the price of silver."

In its prepared statement, Sunshine said that proceeds from the $50 million sale would be used in part to finance silver exploration and development on the company's properties, situated in the Coeur d'Alene mining area of northern Idaho. They also would be used, it added, to complete a second mine shaft and to develop a pilot refining plant.

United States Department of Justice
WASHINGTON, D.C. 20530

ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

12 FEB 1980

RECEIVED
FEB 15 1980
Banking, Finance & Urban Affairs Committee

Honorable Henry S. Reuss
Chairman
Committee on Banking, Finance
and Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your letter of December 19, 1979, to the Attorney General, concerning an inquiry of Andrew G. Racz of Philips, Appel & Walden, Inc. of New York City about the purchase by Arab Investors Group, S.A. of a 19% interest in the Sunshine Mining Company (27% if such group exercises an option to buy additional shares). Mr. Racz in essence expresses two concerns, that the transaction could lead to domination of the United States silver industry by anonymous Arab investors and that the monetary stability of this country could be threatened.

Mr. Racz appears to be well acquainted with the silver industry, and I see no reason to doubt the statistics he cites to demonstrate the importance of the Sunshine Mining Company in it. On the other hand, it is not clear that this firm dominates silver production or pricing either in this country or internationally. Our Economic Policy Office informs me that Sunshine Mining Company produces approximately 10% of the United States newly-mined silver and approximately 1% of the world's newly-mined silver. In addition, newly-mined silver competes with silver made from scrap and with inventories of silver. United States silver output from scrap has generally been larger than that from mines.

The price of spot silver appears to be determined in a competitive environment. The spot price is affected, among other things, by the price of the near-term futures contract on the New York Commodity Exchange, and the futures price is determined by demand and supply forces throughout the world. The recent increases in the spot price of silver and other precious metals appear to stem from the high rates of inflation (actual and expected) in the United States and other industrial countries, as well as from perceived instability in the international political situation. The especially large price increases during the past few weeks may be largely the result of the events in Iran and Afghanistan.

Mr. Racz's assertion that this transaction could affect the monetary stability of the United States would require clarification before I would understand his reasoning. The United States is not on a silver standard or bimetallic standard. Also, I am informed, increases in silver prices have an imperceptible effect on the overall inflation rate in the United States.

Finally, let me observe that the Department of Justice, consistent with the antitrust laws' purpose to encourage competition from all quarters and this country's policy of promoting free international trade, does not automatically view foreign investment in the United States with suspicion. Of course, in any circumstance where there is evidence that foreign investors, or American investors, may intend to restrain competition or to distort normal market forces, we would consider initiating an investigation. Thus we encourage citizens, including Mr. Racz, to contact us if they have reason to believe that conduct may violate the antitrust laws.

I appreciate your having referred this letter to the Department of Justice. Please do not hesitate to ask me for further assistance on this or any other matter.

Sincerely yours,

Sanford M. Litvack

Sanford M. Litvack
Special Assistant to the
Attorney General

pages tightly bound

5. FINANCIAL FUTURES AND BANK GUIDELINES

1. ARTICLES

AMERICAN METAL MARKET 2-21-80

Sunshine Has Doubled Offering Of Silver Certificates to $100M

NEW YORK — Sunshine Mining Co., which operates the nation's largest silver mine, said it doubled its earlier proposed offering of silver certificates to $100-million in order to finance capital projects it is planning to undertake.

The Dallas-based firm also reported that 1979 net earnings were almost three-and-a-half times 1978 earnings and sales advanced 44 percent.

A spokesman for the company declined to elaborate on the capital projects under consideration, except to say they were "fairly substantial" and had not as yet been approved.

The nation's sixth largest silver producer said the offering of certificates will be made in March through underwriters Drexel Burnham Lambert Inc. The certificates, to mature March 1, 1995, will carry a $1,000 face value, or the price of a certain number of troy ounces of silver bullion (AMM, Feb. 5).

The company said it was also considering calling its $13.3-million in outstanding convertible subordinated debentures, due April 15, 1988.

Separately, Sunshine said that the sale earlier this month of its Anchor Post Products Inc., the Pisco Chrystal and Premier Metals divisions resulted in a gross purchase price of $29-million in cash and notes.

The mining producer reported income from continuing operations rose to $5,653,000, or $1 per share last year, compared with $1,019,000, or 18 cents per share in 1978. Mining revenues advanced to $23,945,000 from $16,450,000.

Earnings from 1979 discontinued operations amounted to $2.8-million and profit of $3.4-million from the disposal of discontinued operations produced net income of $11.7-million, or $2.13 per share.

In 1978, profit of $2.2-million from discontinued operations resulted in net income of $3.2-million, or 56 cents per share.

3-Month Earnings

Income for the three months ended Dec. 31, 1979, increased almost three times to $2,825,000, or 49 cents per share, from $998,000, or 18 cents per share.

Net income from continuing operations for the quarter totaled $2,049,000, or 39 cents per share, compared with $761,000, or 14 cents per share.

Net income from continuing operations for the quarter totaled $2,049,000, or 39 cents per share, compared with $761,000, or 14 cents per share.

Income from discontinued operations rose more than two-and-a-half times to $576,000, or 10 cents per share, from $225,000, or 4 cents per share.

Mining Revenues

Mining revenues in the quarter advanced 71 percent to $8,081,000 from $4,706,000.

Sunshine's chairman G. Michael Boswell said that production from the Sunshine Mine in Kellogg, Idaho, was less than anticipated in 1979 due to the accelerated level of development activity, including the sinking of a new underground shaft, and repairs to the shaft that took approximately four weeks.

"Production is now at normal levels and prices are substantially ahead of those realized during 1979," Boswell said. "Therefore, we expect a satisfactory first quarter for 1980," he added.

RACZ
INTERNATIONAL

PHILIPS, APPEL & WALDEN, INC.
111 Broadway, New York, N.Y. 10006 (212) 964-9000

a fortnightly newsletter
February 21, 1980

Member New York, American and Other Principal Stock Exchanges
No. 85

SILVER- AND GOLD-INDEXED BONDS

A NEW ERA...

A MONETARY REFORM

The recently announced $100 million Sunshine silver-indexed loan offering, which is described in the following paragraphs, represents a historical turning point in our monetary system.

"Andrew G. Racz, an authority on silver and President of Racz International, New York, called the move 'the historical turning point in legitimatizing gold and silver as backing for currency.'"

- The New York TIMES
Tuesday, February 5, 1980

SUMMARY OF OFFERING

Issue	$100,000,000 of % Silver Certificates Due March 15, 1995 (the "Silver Certificates").
Payment of Interest	March 15 and September 15.
Indexed Principal Amount	For each $1,000 face amount Silver Certificate, the greater of $1,000 or the price of troy ounces of Silver (determined as provided in the Indenture).
Redemption	Callable at the Indexed Principal Amount on or after March 15, 1985, if such amount is $2,000 or more for a period of 30 consecutive days.

* * *

The Swiss franc and the Deutschmark are no longer safe havens for excessive dollar holders -- the flight from paper currencies is on.

Editor: Andrew G. Racz
Associate: Steven Bayern

Circulation Mgr.: Jo Tortorici

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WALL STREET JOURNAL
P. 13
MAR 27 1980

N.B. Hunt Group Shocks Silver World With Plan for Bonds

• • •

Bullion-Backed Offer May Be To Help Finance Holding With Diminished Value

E

By JULIE SALAMON
Staff Reporter of THE WALL STREET JOURNAL

Nelson Bunker Hunt has stunned the silver world again.

The Texas billionaire said in Paris that he and four wealthy Arab investors plan to sell bonds backed by about $3 billion of silver they own.

One of the four is Naji Nahas, a Brazilian resident who recently was disclosed as the mysterious client of ContiCommodity Services Inc., the Continental Grain Co. unit that has been a major silver buyer in recent months along with Mr. Hunt and his brother W. Herbert Hunt.

Mr. Hunt and his associates own more than 200 million ounces of silver, a "substantial portion" of which would be used to back the interest-bearing securities, they said in a brief statement. The bonds would be distributed through a Swiss bank, they said.

Yesterday, silver's price in New York plunged $4.40, to $15.80 an ounce, thus diminishing the value of their silver about $1 billion in a single day and dragging gold's price lower as well.

Analysts in New York said the purpose of the bond sale might be to help finance the group's silver holdings, which have declined in value by about 70% since the metal touched a record $50.35 an ounce in late January. The group is believed to have used profits made while prices were climbing to invest in other ventures. In any case, such a bond offering could yield funds at well under the 20% or so U.S. banks are charging lenders, the analysts say.

In a telephone interview with Mr. Hunt in Paris, where the bond package apparently was being arranged, he said he wasn't worried about the metal's price decline. "I don't think it will really make a difference," he said. "It'll all come out in the wash."

Mr. Hunt declined to offer any details on the bond proposal "just yet." He said the bonds will vary enough in size to attract a wide range of investors, but refused to say what he intends to do with the money he hopes to raise.

The Hunt group's offer has become public while the Sunshine Mining Co. awaits clearance from the U.S. Securities and Exchange Commission for a $100 million silver-backed debt security offering it announced last month, the first such offering that could be redeemed in silver instead of money. The Hunts last year failed in a prolonged attempt to take over Sunshine.

Sources close to Sunshine, observing that the Hunt $3 billion offering dwarfs Sunshine's, were miffed at the timing of the Hunt plan, which would compete with theirs in the European market. "It's a damned coincidence that Hunt's announcing this" when Sunshine expects SEC clearance "momentarily," said one.

Sources say it's likely Hunt will offer his securities as "offshore" bonds, which aren't available to U.S. citizens and needn't be registered with the SEC. Mr. Hunt "likes to keep things private," said one Wall Street bond specialist.

Besides Messrs. Hunt and Nahas, the Hunt silver-bond group includes three Saudi Arabians: Prince Faysal Ben Abdullah al Saud, Mahmoud Fustok and Sheik Mohamed al Amoudi.

Prince Faysal likely met Mr. Hunt through his father, Prince Abdullah, commander of the Saudi national guard. Prince Abdullah shares with Mr. Hunt a passion for thoroughbred horses, which they both consider a good investment, says David Mizrahi, editor of the MidEast Report. Mr. Nahas also reportedly is a racing enthusiast. Mr. Hunt said earlier this year that he had met one of ContiCommodity's silver customers, whom he described as "an Arab living in Brazil," at a racetrack in Paris.

Traders in New York were dismayed to learn of the Hunt-Nahas connection. "It raises some nasty questions," said one commodity specialist. As silver prices were soaring last fall, the Hunts consistently denied that their silver buying had anything to do with ContiCommodity and vice versa. Walter Goldchmidt, executive vice president of Continental Grain, said that Mr. Nahas "is a customer of Conti's," but declined to say whether the brokerage concern had bought silver for the Brazilian investor.

Ironically, much of the selling on the New York Commodity Exchange that sent silver prices sliding yesterday was done by Alvin Brodsky, a floor trader who does business for the Hunts "from time to time." Mr. Brodsky said his sell orders came from "big brokerage houses" and that he hadn't had any contact with the Hunts yesterday.

The New York Times
THURSDAY, MARCH 27, 1980
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Hunt Group Sets Silver-Backed Bonds

PARIS, March 26 (AP) — Nelson Bunker Hunt, the Texas billionaire, announced today that he had agreed in principle to participate in a joint venture to market bonds backed by $3.5 billion in silver bullion.

Mr. Hunt, of Dallas, is an heir to the fortune of H.L. Hunt and one of the world's wealthiest men. Last year, he bought large quantities of silver on commodities markets, throwing them into disarray. Normally, these markets trade contracts to deliver a commodity at a future date and are not prepared to deliver large amounts of the commodity itself.

In today's announcement, Mr. Hunt said he would join four other men with large silver holdings to market silver-backed bonds.

The other participants were identified as Prince Faisal ibn Abdullah Al Saud, Mahmoud Fustok and Sheik Mohammed al Amoudi, all of Saudi Arabia, and Naji Nahas of Brazil.

Mr. Hunt said the group owned more than 200 million ounces of silver bullion, which will back the interest-bearing bonds. The bonds will be distributed through big European banks in denominations of varying sizes, according to Mr. Hunt.

At current prices, 200 million ounces of silver is worth about $3.5 billion. Silver bullion ended trading in London today at $17.50 an ounce.

Mr. Hunt's silver-buying activities in 1979 helped drive the price from about $6 an ounce to a peak of more than $50.

Effect of Proposal

By H.J. MAIDENBERG

The silver-backed bond offering proposed by Mr. Hunt and the Saudi Arabian and Brazilian investors could provide the group with $3 billion to $5 billion in hard European currencies and could cause some changes in the money markets because the move comes close to remonetizing precious metals, according to some currency experts in New York.

As Andrew Racz, president of Racz International, a division of the brokerage house of Philips, Appel & Walden Inc., put it:

"The Hunt group, in effect, would be printing their own money. More important, they could be paying 4 percent for West German marks and Swiss francs, dollars, or whatever credit they want, while the Treasury is being forced to borrow for 17.5 percent in today's money market.

"Not only can the Hunt group raise hard cash at half the rate Washington must pay, but their bonds could upset the Eurobond market. Assuming the proposed bonds are fully backed in silver at today's spot price of about $16, they could raise $3.5 billion with, say, an 8 percent cost.

"If, as we suspect, the bonds will be 50 percent backed by metal, then the figure rises to $6 billion plus at a 4 percent cost."

By comparison, Mr. Racz said, the total amount of Eurobonds denominated in West German marks was estimated at the equivalent of $5 billion, while those denominated in Swiss francs were put at about $6 billion.

Vote of Confidence Seen

James Sinclair, head of a leading precious metals and foreign currency brokerage house bearing his name, said the backing of the proposed Hunt "silver bonds" with the metal, rather than making the securities convertible into silver at some future date, "translates into a bullish vote of confidence in precious metals."

"If they proposed to make their bonds convertible into silver," Mr. Sinclair said, "many people would have considered that the Hunts were trying to get out of their metal."

Mr. Racz added that the Sunshine Mining Company, the nation's biggest silver producer, planned to offer $[illegible] million in silver certificates within a few days. The Sunshine paper is expected to be 50 percent backed by the metal but not convertible for five years.

The concept of the silver certificates was developed by Sunshine executives at a time when a Hunt family company, the Great Western United Corporation, controlled Sunshine, according to officials of Drexel Burnham Lambert, the brokerage house handling the Sunshine offering. Much of the impetus for that project, according to Drexel officers, came from Mr. Hunt.

The New York Times/[illegible]

Nelson Bunker Hunt

HUNT BOND OFFER –

AMERICAN METAL MARKET, MARCH 28, 1980

Silver Prices Plunge in Comex Trading

By [illegible]

NEW YORK — Speculators apparently abandoned the silver market yesterday as prices on the Commodity Exchange here dropped below the $1-per-troy-ounce limit for the forward months and plunged $11.12 per ounce to $10.80 for the spot April contract.

Yesterday's price collapse followed news that a group of five silver speculators, led by Nelson Bunker Hunt, the Dallas oil billionaire, would offer bonds backed by silver, but not redeemable in the precious metal, for sale in Europe.

In addition to Hunt, who is said to have once held as much as $3-billion worth of silver before the market drop of the past two weeks, three Saudis and a Brazilian are participating in the new bond issue. The issue is similar to one offered by Sunshine Mining Co., Dallas (AMM, Feb. 21) although Sunshine has said its issue will be redeemable in silver.

Sunshine first contemplated offering a silver certificate issue when Hunt, and members of his family enterprises, were struggling for control of the silver firm. The Sunshine certificates are being underwritten by Drexel Burnham Lambert Inc., here.

Drexel Burnham was involved in the design and planning of the Sunshine certificate offering, but a rep-

(Continued on page 8)

Silver Prices Take Plunge In Comex Trading

(Continued from first page)

resentative of the firm could not comment yesterday on whether the company had any involvement in the new Hunt issue.

The first series of the Hunt silver bonds will be offered shortly, according to a Hunt representative in Geneva. He declined to specify how the bonds would be marketed. According to a statement from the backers of the issue, the total value of the bonds to be offered will be $1-billion.

Doubts Expressed

According to a spokesman for Hunt, the billionaire's motive in offering the bond issue is to "simply give people a silver backed investment opportunity. It will give old age pensioners security."

But silver traders and analysts here doubted that the public will have much faith in the Hunt bond issue, given the sharp drop in silver prices yesterday and the lack of any conversion privileges to exchange the bonds for actual silver.

According to one trader, the Hunt bonds will not offer any competition for the Sunshine silver certificates, but present an opportunity for another method of investing in the precious metal.

Paul Sarnoff, director of research for ContiCommodity Services Inc., here, a unit of Continental Grain Co., cited the lack of conversion privileges as the main deterrent for investing in the Hunt bonds.

'Panic in Pits'

Sarnoff said the drop in silver prices yesterday was due to high interest rates which have made it difficult for speculators to hold their positions. In addition to the high interest, Sarnoff cited "some kind of panic in the pits (on the Comex trading floor) due to forced liquidation because of margin calls."

The Comex late Wednesday relaxed some restrictions it had placed on silver trading by lowering margin requirements and increasing from 400 contracts the number of silver contract positions any single investor can hold.

Margin Lowered

Under the new regulations, the position limits in silver were doubled to 200 contracts on a gross basis in the spot month and following month and 600 contracts on a net overall basis.

The margin requirement was lowered to $25,000 from $30,000 on futures positions of one to 10 contracts; to $35,000 from $40,000 for 11 to 100 contracts; and to $60,000 from a minimum of $80,000 on positions of more than 101 contracts.

The margin for the spot month contract was lowered to $60,000 from $75,000 per contract. As reported, the exchange had sharply restricted silver trading in January, citing a need to control the market that was apparently dominated by a small group of speculators. Although the exchange did not actually say so, the small group of investors was dominated by Hunt, traders here said.

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CHRISTIAN SCIENCE MONITOR
APR 4 1980
p. 10

The play in silver eases, but it may not be over

By Lynde McCormick
Staff correspondent of
The Christian Science Monitor

Los Angeles

Now that the smoke has begun to clear from the recent battlefield of the silver market, analysts are looking for signs of what will happen next . . . and finding very little in the way of solid indicators.

Only two things can be said with any certainty about the near-term silver market: The drama is far from over, and the Hunt brothers, plus four or five Arab investors, still hold the key, short of government intervention.

"A [silver] price level of between $6 to $8 probably reflects a level that responds to production and consumption forces," says David Johnston, executive vice-president of E. F. Hutton & Co. "Somewhere in that range is what you might call the 'true' price of silver, and if the Hunt brothers' silver were to come on the market, silver would probably go to that level. But no one knows if their silver will have to come on the market. No one really knows what they will do."

Mr. Johnston notes that the Hunts and the group of Arab investors had plans to issue silver-backed bonds "as a cheap way to borrow money." They may use that money, if the bond issue works, to buy more silver, in speculation.

Asked if he thinks silver prices will go up or down in the near term, Mr. Johnston replies vaguely, "The answer to your question is, yes."

Walter Frankland Jr., executive vice-president of the Silver Users Association in Washington, D.C., comments on the price question: "The key will be the next week to 10 days. We are still in a tenuous position. Some people are breathing like it's all over, but I'm scared to death for the next week. . . . There is still some excessive speculation out there in the market. It could be that certain people are sitting on large chunks of silver, and we don't know but that they are poised and ready to strike again."

A key factor in bringing silver prices from $50 to $11, Mr. Frankland says, was the rush of individuals to cash in on their own silver holdings, primarily silver coins and sterling silver. Last year, such secondary supplies accounted for 70 million ounces of silver. At the rate they have been coming in this year, he says, the final tally will run at least 100 million ounces for 1980, by far the largest amount ever. "That could be a conservative estimate," he adds.

During January, refineries faced a nine-month backlog for melting the stuff down. The situation became so acute that they stopped paying the high market price for silver and thus slowed the rush and whittled the backlog to six months, where it stands now.

"Decreased usage and increased supplies" helped yank the rug from the high prices, Mr. Frankland says. In addition, the "anxiety factor" tied to events in Iran and Afghanistan began to wear off.

"What happened to silver followed a classic pattern for commodities," says Mr. Johnston. "It is impossible for a commodity to go up that high without falling sharply. Iran, Afghanistan, and the huge increases in inflation pushed it up to unrealistic levels."

If the Hunt silver-backed bond issue actually materializes, says James Sibbet, author of a silver and gold newsletter, "It guarantees that 200 million ounces of silver can never come back onto the market." That much silver is more than a year's consumption for the United States and adds up to more than the combined stock of the New York, Chicago, and London silver exchanges.

APRIL 25, 1980 **American Banker**

Eurofinance

Novel Credit with Floating Margin Dominates Market

By M.S. MENDELSOHN

LONDON— This week in the international capital markets has been marked by a revolutionary type of Eurocredit, negotiations in Warsaw between Poland and its western creditors, and talk of the first gold-linked Eurobond.

The innovation in the Eurocredits market is a loan with a floating margin above a floating base. So far as anyone knows, this is the first of its kind. Indeed, the hallmark of the Eurocredits market during its 15 years of recorded history has been a margin or range of margins fixed at the start of the loan for its duration. The only floating element has been the base rate, usually the London interbank offered rate for three- or six-months dollar deposits.

This week's innovation consists of $40 million for eight years being arranged by European Banking Company for Limesa, a coal mining subsidiary of Enosa, a major Spanish electric utility. The spread for the first year will be ⅞% above LIBOR. At the end of each year, the participating banks will quote a spread based on their assessment of what the market would demand of the borrower for a loan of the same amount over the

(See EUROFINANCE on Page 13)

Eurofinance . . .

(Continued from page 1)

remaining maturity. The actual spread for each year will then be the weighted average of the spreads quoted by the participating banks, but with a maximum of 1⅛% above LIBOR and a minimum of ⅝%. During the course of each year, the borrower can choose whether to take three of six-months rollover periods with the spread applying above three or six months LIBOR. There is a front-end fee which has not been closed, nor has European Banking Company as yet disclosed the names of the other banks taking part in the loan.

The observers here have criticized this new formula as being too complicated, saying that the borrower literally puts himself at the mercy of the lending syndicate, which acts as its own judge and jury in determining an applicable margin for each ensuing year.

No so, said a spokesman for European Banking Company. He pointed out that if the borrower objects to the spread quoted at the end of each year, then the borrower was free to cancel the loan on the spot, without notice. This safeguard applies in addition to the usual agreement allowing prepayment at any time on 30-60 days' notice—exactly which has not yet been decided in the case of this particular loan.

The European Banking Company said the formula was the "test of a new concept in an unsettled environment." But the bank conceded also that "We can do this with every borrower in the world, only with some borrowers some times."

The formula is intended to put banks on a more equal footing with borrowers in the Eurocredits market. It is designed also to encourage banks to lend rather than wait-and-see in the hope that lending margins may widen. The borrower is intended to benefit from spread that will narrow automatically over the life of the credit, assuming no adverse market developments. This is because the spread will be quoted each year for a shorter maturity—seven years in 12 months' time, then six years, then five years and so on.

Preliminary Talks

In Warsaw, representatives of 30 western banks were due to meet Thursday with Bank Handlowy for preliminary negotiations of a new loan or loans to Poland, and Bank of America had, reportedly, been asked by the Polish authorities to circulate an information memorandum. The most common guess here is that Poland will seek about $500 million in the present round of talks, compared with $850 million in Eurocredits obtained in 1979 as a whole.

Poland has become by far the biggest eastern European debtor to the West, with a net $12.8 billion outstanding at the end of last September, according to the Bank for International Settlements. This compares with a net debt of less than $6 billion to western banks and the Comecon area's total net debt of $40 billion to western banks. Talking for the record, bankers here say they will be very reluctant to extend any further credits to Poland, pointing not only to the country's huge debt but also to its bleak economic prospects, as recently outlined in public by Polish official spokesmen. But, when they talk in private, western bankers sound a different note, saying that the banks have been caught in the classical lender's trap. It is thought here that Poland may have to be accommodated simply to help it service debt already outstanding. But that still leaves the lending margins wide open to negotiation.

In the bond market, a spokesman for Drexel Burnham Lambert, Inc. in London said that the company was "considering" marketing a gold-indexed bond issue for a client in the Eurobond market or in New York, but declined to go into any further details. Earlier this year, in New York, Drexel Burnham managed an issue of silver-indexed bonds for the Sunshine Mining Company. This was originally planned as an issue of $30 million, then upped to $100 million and finally launched for $80 million. That in itself says something about an inherently curious hybrid. Fixed-interest securities are classically regarded as relatively stable assets compared with equities, commodities and commodity futures. The link between an inherently stable type of asset with an inherently unstable one like gold or silver doubtless attracts some investors, because the Sunshine bonds were being quoted at 102 in New York this week. But it is a link that others find bewildering. ■

Gannett TODAY/Thursday, June 12, 1980

Hunts stockpiled silver, says broker

RALPH SODA
Gannett News Service

WASHINGTON — A prominent Wall Street broker, who claims that recent speculation in the silver futures market was part of a master plan by the billionaire Hunt brothers of Texas and their Arab partners to establish a new "silver cartel," says he has been denied the opportunity to tell his story to congressional probers.

Andrew G. Racz, president of Racz International, a division of Philips Appel & Walden Inc., a New York securities firm, told Gannett News Service he has "personal knowledge" of some details of the plan.

He said the plan was conceived three years ago by Dallas oilman Nelson Bunker Hunt and executives of Sunshine Mining Co., this nation's largest silver producer.

Herbert Hunt

It called for the stockpiling of hundreds of millions of ounces of the world's silver to be used as the base for a new global currency, which, Racz said, would create "monetary chaos for the dollar."

He said the stockpile was to be amassed through the purchase of silver futures contracts and silver-backed certificates issued by Sunshine, and was to be financed by foreign banks and a secret consortium of oil-rich Arabs, including members of the Saudi Arabian and Kuwait royal families.

Sunshine is seeking to raise $250 million by selling silver-backed certificates in the Eurodollar market, Racz said, by agreeing to pay the lenders back in silver when the loans come due.

This could mean that millions of ounces of silver would be taken off the American market, creating shortages in the precious metal and concentrating it in the hands of a few. The plan, he said, could be the beginning of a world barter system that would disrupt the international monetary system as we know it.

In a copyrighted story last month, Gannett News Service reported that the Hunt brothers, Bunker and W. Herbert, and their Arab partners were amassing a silver stockpile to be used for the purchase of Middle Eastern oil, either by direct exchange or through the medium of a new silver-backed currency.

The Sunshine silver certificates and a Hunt-Arab plan to issue millions of dollars in bonds backed by 300 ounces of silver could be the forerunner of the monetization plan, GNS reported.

Last week, Racz told GNS, "There is no doubt in my mind they (the Hunts, Sunshine Mining and their Arab partners) hope to monetize silver."

Racz said he had written in December to Rep. Henry S. Reuss, D-N.Y., chairman of the House Committee on Banking, Finance and Urban Affairs, warning of the effect this would have on the dollar and urging an investigation.

He said he followed this in April with a similar letter to Rep. Benjamin Rosenthal, D-N.Y., chairman of a House subcommittee which is holding hearings into the wild gyrations in the silver market in the past 18 months. During that time, the price of the precious metal rose from $5.40 an ounce in January 1979 to a record high of $50 last January, before plunging to $10.80 last March 27. It is now trading at [illegible] an ounce.

"I have offered to testify and bring what documentation I have before the committee," Racz said, "but my offer has not been accepted."

A member of the subcommittee staff said Racz was not called because the subcommittee has authority only to oversee governmental agencies and does not call members of the general public to testify.

"Mr. Racz has been put in touch with an investigator of the Securities and Exchange Commission and his letter to us has been made a part of the record," the staffer said.

Last week, Racz wrote Sen. William Proxmire, D-Wis., chairman of the Senate Banking Committee, asking to testify before one of that committee's subcommittees which is also probing the silver speculation.

In a copy of the letter sent to GNS, Racz wrote in part.

"I believe that information is at my disposal which would indisputably be a contribution to the hearings being conducted by that subcommittee on speculation in the silver futures market."

But Racz, apparently, will find it no easier to testify at a Senate hearing than at a house hearing. Howard Menell, a counsel for the Banking Committee, said Racz's letter will be made part of the hearing record.

5. FINANCIAL FUTURES AND BANK GUIDELINES

1. ARTICLES

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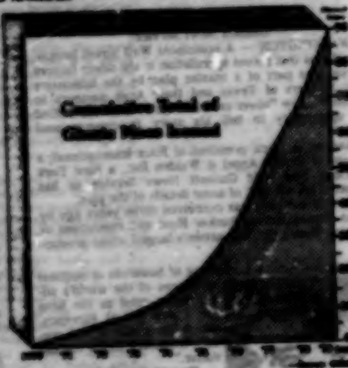
Built on Stilts:

Overspeculation, Thin Margins Shake the Market for Ginnie Maes

By [illegible]

[illegible]



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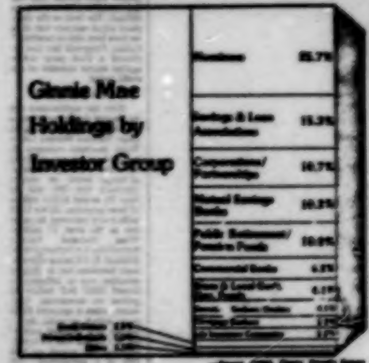
Ginnie Mae
Holdings by
Investor Group

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BUILT ON STILTS

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costs run 200 to 300 basis points above the loan providing mortgage money.

The situation has bred problems for housing, heavily dependent on the secondary mortgage market to provide funds. A demoralized Ginnie Mae market could deter fresh commitments by unhappy investors. Also, with mortgage yields way up, as the Morgan Guaranty Survey pointed out the other day, Ginnie Maes and other mortgage-backed securities now have less allure. "Their success in tapping the nontraditional market has depended," the analysis says, "on offering investors yields substantially above those available on high-quality corporate bonds."

Self-Regulation

The securities industry is now moving aggressively to do away with the losses [illegible] the Ginnie Mae market. Under the auspices of the Public Securities Association, a new group, PSA Self-Regulation Inc., has been formed with an initial membership, according to Joseph W. Sack, PSA deputy executive director, of 26 major firms representing 90% of Ginnie Mae transactions. A PSA-sponsored clearing house operation is being established and uniform regulations adopted which members will be expected to abide by, including key rules regarding fair practices, suitability and record keeping. A primary object is to forestall a growing movement in Washington on the part of a number of agencies to have Congress legislate regulation.

One big hurdle that the PSA Self-Regulation group has been unable to surmount is the question of imposing uniform margin requirements. First Boston Corp. is the only investment banking firm to have adopted in-house margin limits (of 1%) based on a mark-to-market system which reflects fluctuations in price. "We think this is what the market needs," says First Boston's H. James Toffey, "but it has cost us some customers since we launched it two months ago. They simply went to firms that don't have margins." However, others are following suit, including Citibank, which dispatched a letter to clients specifying those of new mark-to-market procedures that took effect Oct. 15.

The idea of margin, of course, is to obtain additional collateral to back dealers' exposure. As Citibank Vice President Dan Sheets said in his letter, "In the event that collateral is not promptly received, Citibank will have the unconditional right to close out the customer's open position and collateral, and to immediately collect from the customer any losses which may be sustained by Citibank."

Industry-wide imposition of margin requirements, however, may be difficult. A few months ago the Justice Department responded negatively to a query from the industry self-regulation group as to how the agency would view industry-imposed margin limits. Justice said it [illegible] with Sen. Harrison Williams Jr., Comptroller of the Currency John G. Heimann recently observed that one way around this problem might be to allow the group to [illegible] of uniform margin requirements. Otherwise, he suggested federal sponsorship of a [illegible].

On balance, though, Heimann backs securities industry self-regulation of the Ginnie Mae market, which, he believes, can be accomplished on a more timely basis and with less effort than a federal program. Heimann's views, however, aren't shared by everyone in Washington. Describing her department as "increasingly impatient" with the industry's failure to establish an effective self-regulation plan, GNMA's Fred Taylor wrote Senator Williams that "the time has come to explore appropriate avenues for a more direct Federal regulatory role. . . ." And that seems to be just the direction things are taking. Howard Menell, of Sen. Williams' staff on the Banking, Housing & Urban Affairs Committee, says, "There almost certainly will be some kind of regulation. We'll be holding hearings on the matter, probably in the spring."

In the meantime, the agencies themselves are attempting to police their constituents. The FHLB adopted rules that, for one thing, eliminate front-end lending of commitment fees, and impose other standards to reduce speculation by prohibiting new, prospective activity, as well as make [illegible] more responsible for [illegible]. The National Credit Union Administration has [illegible] what Chairman Connell likes to refer to as "Draconian" measures by prohibiting speculation. "As far as we're concerned, the problems have stopped," he says flatly.

The Comptroller's office likewise has sought to rein in the national banks via restrictions on forward commitments. However, his rulings did not apply to state-chartered banks, and under a draft policy statement adopted at a meeting of government banking regulators just a few weeks ago, new rules governing fee income, accounting and reporting practices and investment policies are likely to be soon forthcoming for all banking institutions.

The SEC, for its part, because of the unregulated nature of the government bond market, has found itself, as Chairman Harold Williams has expressed it, in dealing with the problem in an "enforcement posture." In the aforementioned G. Weeks case, the SEC is taking a new approach by charging that the firm's "standby with put-call" agreements are actually securities subject to registration. Some members of the securities bar are convinced that the SEC may be trying to use this case as a "back door" approach to regulating government bond dealers. However, [illegible] in his office in Atlanta, SEC lawyer James Long said that the Commission's charge fits only the way Weeks Securities allegedly did business. "It was unique to this firm."

Where does the Ginnie Mae market go from here? Its importance is unlikely to diminish, certainly not when it occupies such a pivotal role in housing and also when participants turn over [illegible] volume of $1 billion daily. But, as the foregoing suggests, it's also due for some significant changes in view of the [illegible], come [illegible] soon.

WSJ Nov 13, 1979

'Ginnie Mae' Speculation Prompts Plan To Regulate Federal Securities Industry

By Burt Schorr

Staff Reporter of The Wall Street Journal

WASHINGTON – The era of largely unregulated sales and speculation in the $1 billion-a-day market for federally backed securities may be drawing to a close.

In the works here is legislation that would place the government securities industry under the same general rules that govern other types of securities trading and marketing.

Sales of federally backed securities have boomed along with rising interest rates since the mid 1970s. With those sales have come serious market abuses, principally in connection with the mortgage backed "Ginnie Mae" certificates issued by the Government National Mortgage Association. Aware of the government's concern about speculative trading, Ginnie Mae dealers have been trying for two years to construct their own self-regulatory organization. However, dealers representing a sizable minority of total Ginnie Mae business thus far haven't joined.

Ginnie Mae securities, which are sold to the public in minimum units of $25,000, represent shares in pools of government-backed home mortgages.

Congressional Intervention

Now, Sen. Harrison Williams thinks it's time for Congress to intervene. With speculation in Ginnie Mae certificates "footloose and fancy free, the force of law would be the best way" to regulate the industry, the New Jersey Democrat asserts. Mr. Williams's words carry weight because he is the No. 2 Democrat on the Senate Banking Committee and probably is Capitol Hill's most knowledgeable lawmaker on securities questions.

Within recent days, Mr. Williams has directed aides to begin drafting legislation to bring the government securities business under Washington's scrutiny. Dealers in all kinds of government securities, including Treasury notes, would be covered, as well as those in Ginnie Maes, estimated to be well over 300 banks and securities firms in all. The broad coverage is needed to prevent abuses in the other relatively trouble-free government markets once Ginnie Mae sales are sanitized, a Williams aide reasons.

In a letter to Sen. Williams earlier this year, Securities and Exchange Commission Chairman Harold Williams suggested that the SEC would welcome being assigned a major responsibility to oversee nonbank dealers.

If Congress goes along with the bill Sen. Williams is contemplating, the result could be similar to the 1975 federal securities law amendments that created the Municipal Securities Rulemaking Board in response to abuses in the previously unregulated municipal securities industry. That would produce a panoply of federal requirements for government securities dealers, from net capital and margin minimums to customer safeguards.

Ginnie Mae Speculators

Ginnie Mae speculators chiefly trade in forward, or futures, contracts. These contracts are often sold without any down payment. If interest rates decline during the life of the contract, the price of the contract rises, sometimes producing fat profits.

On the other hand, if interest rates rise, forward buyers can lose considerable amounts, as banks, credit unions and other Ginnie Mae speculators have learned. Indeed, dealers began talking about the need for self-regulation after the University of Houston lost more than $17 million on Ginnie Mae forwards. At one point, the Texas institution had more than $250 million in purchase commitments outstanding.

Evidence of dangerous Ginnie Mae speculation continues to surface. Earlier this year, Reliance Mortgage Corp. of Denver had to turn over about $545 million of mortgage obligations to another company after suffering a reported paper loss of $5 million on Ginnie Mae forwards. The SEC, for its part, has said that it's investigating a number of securities firms whose capital positions could be in jeopardy if their customers don't make good on forward commitments. In one case cited by SEC Chairman Williams, a firm had 240 customers in 36 states obligated to buy $250 million of Ginnie Maes.

Robert Dall, a Salomon Brothers partner who has taken a leading role in the self-regulatory effort, fears the fallout from the Oct. 6 credit-tightening action by the Federal Reserve Board and resulting collapse of bond prices is still to be seen. In the next few months forward buyers will be faced with taking in Ginnie Maes "that immediately will be under water, a terrible piece of adversity that faces the Ginnie Mae market," Mr. Dall said.

Hedging With Financial Futures

Small band of savvy corporations insulate themselves against rising interest rates in planning for upcoming cash needs. One pension fund manager also uses futures contracts to protect his bond portfolio.

It would be considered the final stamp of approval. In full-page ads in leading newspapers recently, a bold headline proclaimed: THE NEW YORK STOCK EXCHANGE INTRODUCES THE NEW YORK FUTURES EXCHANGE. Come spring, if all goes as planned, the new exchange will inaugurate trading in financial futures on its new, $12 million floor.

Recognition by the world's foremost exchange is certainly welcome, though a bit late. Trading in financial futures is already booming on other exchanges, notably the Chicago Board of Trade and the International Monetary Market division of the Chicago Mercantile Exchange. For example, trading in Treasury bill futures on I.M.M. rose from 110,200 contracts in 1976, the year such operations began, to 321,700 in 1977 and zoomed to more than 1.9 million last year.

All this activity is providing new business for brokers and profit-making opportunities for speculators. But more than that, financial futures (also known as interest rate futures) are now being used by a handful of savvy companies to protect themselves against fluctuations in interest rates—and in these days of fast moving money markets, that is welcome protection indeed. "The use of interest rate future gives a money manager more flexibility in carrying out his strategy and hopefully allows that manager to be more efficient," says Seymore N. Lotsoff, vice president and portfolio manager for fixed-income securities at Sears Investment Management Co. (SIMCO), a wholly-owned subsidiary of Sears, Roebuck & Co.

Favorite Contracts

Financial futures trading covers a number of vehicles such as Ginnie Maes and commercial paper. But the kinds that interest corporations most are futures contracts in 90-day Treasury bills and in long-term government bonds. Like similar contracts in commodities and other areas, financial futures are simply agreements to either buy or sell a specific amount of a money market instrument at a specific price at a given time. For instance, a corporation may contract to sell $1 million of 90-day bills at 87 in June 1980. The price of the contract is directly influenced by the current bill yield, and depending on whether interest rates rise or fall, the corporation stands to make or lose money.

Individuals may speculate in these contracts, but corporations don't. They use financial futures as a hedge in one of two ways: to lock in a certain rate of interest for a future financial transaction or to protect their pension funds against an erosion of principal due to a rise in interest rates. Esmark, Inc., was the first industrial company to trade 90-day Treasury bill futures when those instruments were introduced on the International Monetary Market back in January 1976. "The concept of futures markets was not foreign to us," notes Jay D. Proops, vice president and treasurer. "Our Swift division has routinely used grain futures for hedging purposes." Proops also points out that a company such as Esmark wouldn't think of not hedging a physical commodity, and he adds: "Money, too, is a commodity."

Esmark, along with companies such as Norton Simon, Inc., and Stauffer Chemical Co., use financial futures primarily as a means of locking in an interest rate for commercial paper offerings they contemplate making in the months ahead. Take a corporation that knows in February that because of its seasonal cash flow it will have to issue commercial paper in June. If the firm's cash manager believes that interest rates are trending lower, he of course just sits tight in anticipation of taking advantage of the decline. But if he believes that rates are headed higher, he can protect the company against those increased

I.M.M. Boom: From 110,000 contracts in 1976 to more than 1.9 million

"If you don't have a firm conviction which way rates are heading, it may be best not to hedge with futures," says Drucker of Stauffer Chemical. "If you are wrong, you will actually increase your borrowing costs."

charges by selling Treasury bill futures for delivery in June.

If the money manager guesses right and interest rates do indeed rise, then the value of futures contracts in Treasury bills will decline, since prices of fixed interest investments move inversely to rates. Then the money manager can again go into the futures market to buy a contract to offset the first one, and the company pockets the difference between the first and second contracts as profit. This profit, in turn, can be used to offset the higher interest rate the corporation will have to pay when it sells its commercial paper. The company, in effect, will be able to borrow in June at the lower interest rates that prevailed in February.

The strategy can be used in reverse for a company that knows it will have excess funds some time in the future and wants to invest it at current high interest rates. If he believes that interest rates are going down, the money manager simply purchases a futures contract giving him the right to buy Treasury bills later on. This locks in current yields for the company's future excess funds. "Without the use of interest rate futures, a company is always at the mercy of the existing yield curves," comments assistant treasurer Kenneth A. Drucker of Stauffer Chemical Co.

Minimal Cost

There's a price for this protection, of course, but it's minimal. Treasury bill contracts can be bought on a margin of only $1,500 per $1 million contract. Brokerage commissions are $60 per contract, but big customers can negotiate discounts that range up to 50%.

As might be expected in an extended period of rising interest rates, the corporations using the financial futures markets have, with one exception, done so to hedge their borrowing costs rather than their investments. But there is one exception, SIMCO, which began using the financial futures markets in the summer of 1979 to hedge the principal in the pension funds it advises. Lotsoff explains how.

"Let's say we invest in a 30-year corporate bond, and let's say we expect interest rates to rise. Now that puts at risk the principal value of that bond because as interest rates rise, the price of the bond goes down. There are a couple of things we can do in that situation, and one is just to sell the bond. But another alternative, which may be more attractive, is to hedge that corporate bond by selling a futures contract on long-term government bonds. The value of that futures contract, when liquidated, would at least partially compensate for the drop in the value of the bonds."

On the other hand, adds Lotsoff, if a money manager expects interest rates to fall, there may be an advantage in buying futures contracts for Treasury bonds. A company could in effect buy bonds at today's lower prices and take possession of them in a year or so, when the value has already appreciated in response to lower interest rates.

Moreover, Lotsoff notes, since the futures contract can be bought for only a small portion of the total value of the contract (the bond futures margin is $1,600 per $100,000 contract), the money that would have been spent on the bond can be placed in a one-year certificate of deposit that yields more than the bond would. "At the end of the year, the one-year CD is cashed in and the money is used to buy the bonds for which the company contracted a year earlier," Lotsoff concludes.

While SIMCO is, as far as is known, the only private pension fund adviser currently using interest rate futures to hedge its portfolios, a major brokerage house and a Chicago-based consulting firm recently queried thirteen pension fund managers and ten replied that they intended to use the futures hedge sometime in the months ahead.

The degree to which corporations hedge their cash flow varies, but none is hedging 100% of its money, primarily because a rule of thumb for money managers is never to put all the eggs in one basket. Moreover, as Drucker at Stauffer Chemical explains, "If you don't have a firm conviction as to which way rates are heading, it might be best not to hedge with the futures markets, because if you are wrong you will actually increase your borrowing costs." Drucker hedges over 25% of Stauffer Chemical's issues, but never all.

Esmark currently hedges only a small portion of its commercial paper issues, says Proops, "although we expect to be using these markets more in the future." But he won't hedge more than 25% of the company's short-term cash flow.

For any money manager considering using financial futures, Proops and the others say one must thoroughly study the markets to understand how the trades are executed, how the futures contracts are priced and how the futures prices react to the cash prices.

Most money managers prefer to have their trades executed on the I.M.M. for 90-day treasury bill futures and on the CBT for long-term government bonds. But Thomas A. Sullivan, vice president of Investments for Norton Simon, uses the New York Commodity Exchange and the American Stock Exchange's commodity division, as well. He notes that these markets are less liquid than the CBT's and I.M.M.'s, but he also points out that as a result prices are sometimes better.

Missionary Work

Convincing top management to use the financial futures markets can be a tough problem. While Proops, Drucker and Sullivan say their top managements quickly okayed their proposals to start trading financial futures, pension fund manager Lotsoff was not so lucky. The idea of using financial futures originated with the board of directors of SIMCO, but Lotsoff still faced the task of convincing the individual pension funds, their trustees, the bankers and even the brokerage firms who would make the transactions that he was exercising fiduciary care in using these instruments. If it weren't for the time it took to educate the lawyers, bankers and trustees, he adds, "we might have been in the market a whole year earlier."

Lotsoff, like the other money managers using the financial futures markets, is quick to point out that financial futures provide "merely another tool in the investment strategy bag. The futures markets in no way eliminate the underlying risk of rising or falling interest rates." Indeed, a money manager using the financial futures must still make that tough assessment as to whether rates will decline or rise. And as Lotsoff notes, "The financial futures are like a hammer in a tool chest that already has a screwdriver and a chisel and a wrench. It is easier to pound in a nail with a hammer than with some other tool, but the person doing the work still has to know where to put the nail and how to pound the hammer." —LYNN ADKINS

JANUARY 29, 1980

American Banker

TRUST BANK

Interest Rate Futures Markets Offer Alternative Investments for Trusts

By FRANK J. JONES
Senior vice president,
New York Futures Exchange

The interest rate futures markets began during October, 1975 when the Chicago Board of Trade began trading a futures contract based on GNMA securities. Soon after, during January, 1976, the International Monetary Market of the Chicago Mercantile Exchange listed a futures contract based on 90-day U.S. Treasury bills. Later, during October, 1977, the CBOT listed a 20-year Treasury bond futures contract. While these exchanges have listed other futures contracts such as commercial paper, one-year Treasury bills, U.S. Treasury notes, and other exchanges have listed contracts similar to these original three, only these three interest rate futures contracts have achieved substantial liquidity. However, the growth and development of these three has been phenomenal. During their short lives, due to their extensive use, they have developed sufficient liquidity that these futures contracts are often more liquid than their related cash markets. This article discusses the potential uses of these markets in managing trusts.

Many claim that the development of these interest rate futures markets has been innovative and regulatory. On the contrary, I believe, their initiation was long overdue. There have been futures markets in agricultural products and metals for years. There have also been developed forward markets for foreign currencies. Finally, foreign currency futures contracts were initiated in 1972 by the IMM. And these futures and forward markets have been used by domestic and multinational corporations as tools of responsible risk management to protect against changing agricultural prices, metals prices and exchange rates.

Futures markets are very similar, in principle, to forward markets, such as the interbank forward market in foreign currencies. But there are significant operational differences. While forward markets are traded over-the-counter by dealers, futures contracts are traded on exchanges. In addition, while forward contracts can typically be negotiated for any date and any denomination, futures contracts are for specific maturity dates and fixed denominations. In practice, another important difference is that forward contracts are delivery contracts, that is, delivery is almost always made or taken at the maturity of the forward contract. On the other hand, while delivery can be made or taken on futures contracts, typically the futures position is liquidated or reversed before the maturity of the futures contract, and deliveries occur on only a very small fraction of all futures contracts. The primary purpose of futures markets is providing protection against price changes, not delivery. Thus, it is easier to reverse, or liquidate, a futures position than a forward position. Finally, current futures prices are much more available than forward prices.

The New York Stock Exchange, aware of its central role in the nation's financial systems and its critical geographical location, continually monitored the development of the financial futures markets, and during August, 1977 began a feasibility study of the New York Stock Exchange's potential entry into these markets. Several consulting-feasibility

(See FUTURES on Page 20)

Futures. . .

(Continued from page 18)

studies, sponsored by the Exchange, concluded that although the markets had grown quickly, they were still in an embrionic stage and that many potential users were not using the markets. On this basis, the board of the New York Stock Exchange, during February, 1979, approved the formation of the New York Futures Exchange. The New York Futures Exchange is committed to contributing to the growth of the financial futures markets by extensive education programs and technological innovations. During June, 1979, the New York Futures Exchange submitted to the Commodity Futures Trading Commission applications to trade futures contracts on 90-day T-bills, 20-year T-bonds, and five foreign currencies. New contracts are also being planned. The New York Futures Exchange plans to initiate trading during the Spring of 1980 based on the recent completion of a very successful membership offering, and the development of its systems and its facilities at 30 Broad Street in New York.

The interest rate futures markets can be and have been used by several areas within commercial banks. Among the early bank users of these markets have been the trading departments who use them for hedging their trading portfolios and arbitrage. Liability management departments have also used them for hedging — for example, to hedge prospective issues of CDs. The future rates paid on variable rate CDs can also be hedged via the T-bill futures markets. Lending departments can use them by basing the amount of, or the rate on, loans secured by securities on whether the borrower has hedged these securities; or by offering borrowers on lines of credit fixed rates rather than variable rates tied to the prime rate, by locking in the future loan rate through the interest rate futures markets. Investment departments can use the interest rate futures markets to improve their portfolio performance, typically, in ways similar to trust departments, the subject of the remainder of this article. Although various bank departments have made considerable use of the interest rates future markets, the extent of their use is still small relative to its potential.

The first and most passive use of the interest rate futures markets by trust departments is for forecasting future interest rates. Although expert judgmental forecasts and sophisticated econometric forecasts may be invaluable, the interest rate futures markets provide the most broad-based indication of market expectations of the future interest rates. Of course, as with any expectation, these expectations may be wrong, and perhaps biased. No actual transactions need to be conducted to take advantage of this aspect of the interest rate futures markets.

The second use of the interest rate futures markets is the construction of alternative forms of investment to pure cash management investments. In this context, the reference is not to an alternative with a higher expected return and a higher risk — often called speculation — but with a higher return at no additional risk relative to an alternative cash market investment over the same investment holding period. Of course, if the interest rate futures markets make it possible to earn a higher return with no increase in risk over the same holding period, their value is obvious. There are two types of alternate investments, based on combined transactions in the interest rate futures markets and the cash markets, to pure cash market investments which have the same risk over the same holding period and often have a higher return.

The first type of alternative investment is called the strip of futures. According to this alternative, the holding period of an initial investment in a short-maturity cash security is extended by the additional purchase of future contracts with one or more maturities, on which delivery can be taken at the maturity of the futures contract(s), as the initial cash market security matures or the securities taken on delivery of earlier futures contracts sequentially mature. If the initial cash market security and the securities taken on delivery of the futures contracts are all held to their maturities, the composite investment, called a strip of futures; has no market risk. The pure cash market investment, to which the strip of futures is an alternative, is a security with a maturity equal to the total maturity from the initiation of the strip to the maturity of the security taken on the last maturing futures contract.

For example, on January 19, 1980, an investor with a planned one-year holding period with no market risk could either: purchase a one-year Treasury security, or purchase a 90-day Treasury bill, and purchase March, June, and September T-bill futures contracts. The latter investment, a strip of futures, would permit him to take delivery of a 90-day T-bill on the March futures contracts as his initial cash 90-day T-bill matured, and, subsequently, take delivery on the June futures contract as the bill taken on the March contract matured, and, finally, take delivery on the September contract as the T-bill taken on the June contract matured. The T-bill taken on the September contract would be held to maturity, thus completing the one-year holding period. There is no market risk over the one-year holding period on either the purchase of the one-year Treasury security or the strip of futures. Thus, the investor should choose solely on the basis of the certain return he would earn on either alternative. If the strip of futures provided a higher yield, and it often does, he should "invest in the strip of futures."

The second type of alternative investment is called a hedged yield curve ride. An investor must purchase a security with a maturity equal to his intended holding period to avoid market risk. Investors often, however, purchase a security with a maturity longer than their intended holding period in order to increase their holding period. Of course, the latter investment is subject to capital loss if interest rates rise during the holding period. This type of investment, called riding the yield curve, is therefore subject to market risk. Bearing market risk is the cost of attempting to increase potential return.

However, interest rate futures contracts can be used to eliminate the market risk by riding the yield curve. The cash security purchased can be hedged against capital loss by taking a short position in a futures contract based on cash security purchased and with a maturity date at the end of the intended holding period. For example, an investor with a three month holding period who decides to purchase a six-month Treasury bill to increase his return over this holding period, can hedge against price declines on the bill held by taking a short position in a 90-day T-bill futures contract with a maturity of three months hence. Specifically, on January 19, 1980, the investor who wished to invest until March 19, 1980 with no market risk, could purchase a Treasury bill which matured on June 19, 1980, and also take a short position in a 90-day T-bill futures contract. The six-month T-bill initially purchased could be delivered on the futures contract at the contract's maturity, when the bill has three months left to maturity, at the price transacted on January 19, thus demonstrating the riskless nature of the transaction. The short futures position eliminates the risk from the ride of the yield curve; and, thus, this type of transaction is called a hedged yield curve ride. Another example of a hedged yield curve ride over a two year holding period is the purchase of a 20-year T-bond and hedged by a short position in a T-bond futures contract with a two year maturity.

Thus, strips of futures and hedged yield curve rides are two mechanisms involving the use of interest rates futures contracts — long positions in the former case and short positions in the latter — which provide alternate forms of investment to pure cash market transactions, and which have no more risk and the potential for higher return.

The third and most important use of interest rate futures contracts by trust department managers is to hedge against interest rate changes. There are two important types of hedges. First, for example, trust department managers who anticipate a price decline in their fixed income securities could sell Treasury bond futures contracts on these securities. If prices did decline, the capital loss on Treasury bonds in their portfolios would be countervailed by a capital gain on the short Treasury bond futures position. Thus, their overall position, cash plus futures, would be immunized from price declines and price increases. Of course, without the futures markets, the trust department manager could respond to an expected bear market by shortening the maturity of hi portfolio. But the interest rate futur markets provide him with an additio tool in portfolio management which often more flexible, cheaper and, at tim may have tax advantages. This type hedge is called a short hedge.

The second type of hedge invo trust department managers who ant pate an inflow of funds but expect t security prices will rise before they wi receive these funds and can invest them. In this case, the trust department manager may lock in a low price and high return today on the eventual investment of the funds by taking a long futures position in a futures contract based on the securities to be purchased, such as Treasury bonds. By purchasing Treasury bond futures contracts today, they lock in today's low price and high yield on purchases to be consummated in the future. This is called a long hedge.

Both short hedges against price de-

(See FUTURES on Page 29)

Futures . . .

(Continued from page [illegible])

creases on securities held in portfolios, and long hedges against price increases on the investment of funds to be received in the future provide trust department managers with an additional tool they can use to improve the performance of their portfolios and gain a competitive advantage. The use of futures markets is often regarded as purely speculative and, in fact, for many uses they are speculative. However, when used in conjunction with actual or planned cash market transactions, the interest rates futures can be used to eliminate or reduce portfolio risk rather than increase risk. In these cases, the choice not to hedge sustains the portfolio's susceptibility to market risk and is speculative. The use of the futures market to hedge is, thus, risk averse. However, the development and implementation of an effective hedge program is not a casual activity. A more detailed article on the development of hedge programs is available, upon request, from the author.

These uses of the interest rate futures markets which either reduce risk or offer a higher return with no increase in risk are obviously consistent with the "prudent man rule." And the recent changes in the Department of Labor's ERISA standards may even consider the purchase of a diversified portfolio of futures contracts "prudent."

Trust departments, as well as pension funds and investment portfolio managers, have been increasing their use of the interest rate futures markets for some of the reasons identified herein. As the futures markets develop and, more importantly, as the potential users become more confident in these markets and more aware the potential uses of these contracts, the growth in the use of these markets by trust department managers will undoubtedly accelerate. ■

SEC Proposes GNMA Rules

The Daily Bond Buyer

WASHINGTON — The Securities and Exchange Commission staff has forwarded to Capitol Hill a draft proposal for the Federal regulation of the government-guaranteed securities market.

The draft legislation, requested by Sen. Harrison A. Williams Jr., D., N.J., comes in response to well-publicized instances of fraud and abuse in the market for Government National Mortgage Association securities.

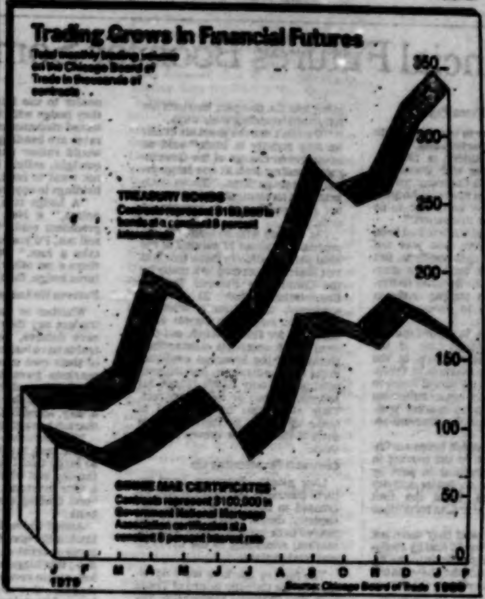
The draft contemplates the creation of a body similar to the Municipal Securities Rulemaking Board to develop rules for the government-guaranteed securities market.

Mr. Williams, a member and former chairman of the securities subcommittee of the Senate Banking, Housing and Urban Affairs Committee and a Senate authority on securities legislation, last year directed aides to begin drafting a measure to regulate all government securities, including GNMA pass-throughs and other mortgage-backed securities, as well as Treasury obligations.

The SEC, discussing government securities in its budget estimate for fiscal 1981, concluded after a review of perceived difficulties in the market that "there is a growing consensus that some form of regulation may be needed to deal with these problems."

The SEC said that in 1979, "this unregulated area of the securities market became a growing concern to the commission" as "unsuitable speculation by investors and questionable practices by dealers were uncovered in a number of instances." ■

American Banker
February 22, 1980



Source: Chicago Board of Trade

The New York Times / March 6, 1980

Financial Futures A Boon for Some

By KAREN W. ARENSON

"Futures have been a lifesaver," said Matthew M. McCaffrey, vice president of First Pennco Securities. "When there has been no other way out of the market, positions in the futures markets have stemmed losses."

Government bond traders around the country say the relatively new financial futures market has reduced the red ink for many of their firms, especially in recent weeks as the regular bond market was becalmed by spiraling interest rates, plummeting values and few bidders.

Despite substantial losses in the value of bonds, estimated by some on Wall Street at $300 million to $400 million, the bond community appears to have come through relatively unscathed. One reason for that, dealers say, is because of the increased flexibility the futures market gives their overall activities.

The term financial futures covers a range of futures trading vehicles, including Treasury bills, notes and bonds, commercial paper, and mortgage certificates guaranteed by the Government National Mortgage Association, known as Ginnie Mae.

All these investments are traded in the spot, or cash, markets. In addition, futures contracts — agreements to buy or sell a fixed quantity of the underlying investment at a set price at a certain date in the future — are traded on this paper on the nation's futures exchanges. Futures on Treasury instruments and Ginnie Mae are used by Government bond dealers in conjunction with their positions in the regular bond markets in this paper, frequently for hedging or arbitrage operations.

Hedging is a strategy used to attempt to neutralize or offset inventory positions in order to limit the negative effects of changing interest rates. Arbitrage is a trading strategy that involves wringing out profits from the differences between prices in one market and prices in another.

"Futures add to the liquidity of the market; they give us more opportunities to buy and sell bonds," said Robert Flynn of A.G. Becker. "Be it Government bonds or cement, if we've got more bids than

Continued on Page D14

NY TIMES MARCH 6, 1980

Financial Futures Boon for Some

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MONEY & CREDIT

Ginnie Mae losses spur investor suits

The sharp rise in long-term interest rates is pummeling the $60 billion market for Ginnie Maes, the mortgage-backed securities of the Government National Mortgage Assn., with serious potential for many Wall Street brokerage houses, and for the already declining housing market. The trouble is erupting in the market for Ginnie Mae forwards—commitments made by institutional investors to accept delivery under specified terms on a specified future date of securities backed by pools of Ginnie Mae mortgages.

Buyers of these forwards are starting to file a rash of lawsuits seeking to recover millions of dollars in losses they sustained when interest rates rose instead of falling, thus eroding the value of the securities. Further, Wall Street executives worry that many investors who contracted to accept delivery on Ginnie Mae securities that have fallen sharply in value will simply renege on the commitments when they come due.

This development could cost the brokerage houses hundreds of millions of dollars. Says one brokerage house specialist in Ginnie Mae forwards: "Institutions such as savings and loans, savings banks, and credit unions could quite simply say, 'We're going to renege on our contracts, and you're going to have to prove us negligent.' Behind the public facade, the Street is very much concerned about this."

The implications for the housing market are also serious, because in recent years Ginnie Maes have been the most important vehicle for drawing pension-fund and other nonthrift money into housing mortgages. Last year Ginnie Maes funneled close to $25 billion into housing. Says the Wall Street specialist: "I know of some other suits that are coming along. What we're seeing is the dismantling of the whole Ginnie Mae forwards market."

Limiting investments. Already lawsuits are popping up. Recently, for example, University Federal Savings & Loan Assn., of Coral Gables, Fla., filed suit against 11 brokerage firms alleging that they controlled Ginnie Mae prices and conspired to earn "enormous profits" at the S&L's expense. It adds that University Federal contracted for "hundreds of millions of dollars" in forwards despite the fact that its assets totaled only about $500 million. Such investments, the suit alleges, were "grossly unsuitable for University Federal."

And in what may be the first instance involving a governmental jurisdiction, Marion County, Ore., which includes the state capital of Salem, is suing Blyth Eastman Paine Webber, as well as the county's own former treasurer, Robert Coe Jr., charging the investment firm "induced" Coe to use county funds to make unauthorized and possibly illegal investments in Ginnie Mae forwards. Marion County is seeking to recover $5.5 million in losses.

All this trouble will certainly fuel already strong pressure on the unregulated Ginnie Mae forwards market to regulate itself or face government regulation. Demands for constraints on this market reached a peak last May when Reliance Mortgage Corp., of Denver, refused to take delivery on $250 million in Ginnie Maes it had agreed to buy. Subsequently the National Credit Union Administration and the Federal Home Loan Bank Board have banned or limited investments in Ginnie Mae forwards by their members.

The rise in long-term rates has eroded the value of mortgage-backed securities

Brokerage houses generally decline to comment on the lawsuits, but privately some brokers feel the institutional investors are acting like spoilsports instead of swallowing losses in what is a highly speculative market. "Some of the people who made investment decisions some time ago are now finding they were not very good decisions," says an executive of one firm named in a lawsuit. "Now they are groping around trying to find an out. If their investments had gone way up, you wouldn't be hearing from them." Roger Klein, president of the Interest Futures Research Corp., agrees: "These things come in bunches, and they are always associated with market declines," he says. "You never hear them when people make money."

But the implications are serious. Explains one broker: "The suits and reneging have a pyramid effect. If they catch on, every disgruntled investor will look for a way to jump on the bandwagon."

Delivery refused. Before filing its suit, Marion County refused to take delivery on $20 million worth of Ginnie Mae forwards. Its suit alleges that Blyth Eastman "knew or should have known" the limitations on Coe's authority to invest county funds. These funds were part of a pool in which some 200 tax jurisdictions in the county deposited short-term funds for investment. The county and some municipalities now face budget cuts because of losses.

Brokers say that investors should accept losses in such a speculative market

Blyth Eastman has picked up the $20 million worth of securities the county refused to accept. They have dropped some $3 million in value. Blyth Eastman is also holding about $10 million of Marion County's securities, partly as collateral, and the county is asking that these assets be transferred to a neutral party to prevent Blyth Eastman from selling any of them to cover its losses. Blyth Eastman is expected also to take the remaining $5 million in forwards held by the county.

Meanwhile, the assets in the county pool are worth some $15 million less than the $45 million on deposit. The new treasurer, 32-year-old Ralph J. Grim, has said he will allow withdrawals only for emergencies. Adding to his troubles, in an unrelated matter, county auditors have discovered that instead of facing 1980 with a $300,000 surplus, the county faces a $1.3 million deficit. ∎

BUSINESS WEEK March 10, 1980

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VOL. CXLV, No. 56

Friday, March 21, 1980

FSLIC Labels GNMA Buyup 1-Time Move

By JAMES RUBENSTEIN

CLEVELAND — The Federal Savings & Loan Insurance Corp. asserted Thursday its extraordinary assumption of millions in futures contracts involved in the failure of a Cleveland-area S&L represents no new policy to assist thrifts in similar straits.

In a statement issued in Washington, the FSLIC said its unusual funding of Government National Mortgage Association pass-through securities at the failed Washington Federal Savings & Loan Association is basically a one-time action.

It is based "on the specific facts and economic conditions now relevant," said the FSLIC in explaining its decision to fund the huge portfolio of GNMAs oversubscribed by Washington Federal.

Under a takeover agreement worked out by the FSLIC and the Federal Home Loan Bank Board earlier this week, Washington Federal assets and five offices were taken over by the $1.5 billion-deposit Broadview Savings & Loan Association of Cleveland.

The FSLIC declined to state the amount of GNMAs it is expected to fund under its Washington Federal action, but

(See BROADVIEW on Page 20)

Broadview . . .

(Continued from page 1)

said it has already extended $53 million to cover commitments and expects the figure to climb to $80 million by the end of the month. Industry sources said the amount could easily reach $100 million.

"That would not be out of the ballpark," said one source close to the takeover negotiations.

In its statement on Washington Federal, the FSLIC, which is the insurance arm of the Federal Home Loan Bank Board, stressed that it had the authority to assist S&Ls such as Washington Federal "in danger of default" on the "funding of certain GNMA obligations."

The agency said it "decided to take this action to protect interests of the depositors in Washington Federal and to promote stability in the financial community."

The FSLIC said it is assuming these GNMA commitments made by the University Heights S&L, "which are valid, binding and legally enforceable obligations."

However, the FSLIC said "We wish to emphasize that if other cases involving the funding of similar obligations occur" the agency would review them on a case-by-case basis "in light of the circumstances surrounding" each one.

The FSLIC said it has no obligation "to assume any liability of an association in default other than that of insured deposits."

The exact makeup of Broadview's winning offer was not immediately clear, but Paul L. Csank, secretary of Broadview, said it involved a complex formula by which the Federal Savings & Loan Insurance Corp. agrees to pay Broadview an estimated $140 million to take over Washington Federal's good assets.

The $140 million, however, "is subject to change by our auditors," according to Mr. Csank, a Cleveland attorney.

Broadview officials Thursday said the deposit runoff at Washington Federal offices in the wake of the takeover has been held to about $1 million.

The merger has been viewed with "great enthusiasm" by Broadview officials, who said the Washington Federal's five offices "will mesh perfectly with ours without overlap." Broadview has 36 offices in metropolitan Cleveland, while Washington Federal has five.

Washington Federal officials were not immediately available for comment on the GNMA overextension, but the institution had issued a statement Wednesday warning it would sue the FHLBB for the unfair "involuntary takeover." ■

38 THE WALL STREET JOURNAL
Tuesday, March 25, 1980

Commodities

Rapid Expansion of Financial Futures May Prompt Moratorium on New Issues

By ROBERT PRINSKY
Staff Reporter of THE WALL STREET JOURNAL

The financial futures pie is expanding rapidly, but federal regulators want to make sure that competing commodity exchanges don't cut the pie into too many pieces.

In the first two months of this year, trading volume in financial futures has more than doubled on the two big Chicago exchanges that originated these instruments, which are contracts for the future delivery of such financial items as Treasury bills and British pounds at specified times, prices and places.

The latest volume gains, which reflect the recent turbulence in bond and currency markets, extend a period of heady growth that has encouraged competing commodity exchanges in New York to seek—and obtain—authority to list financial futures themselves. Even the New York Stock Exchange is seeking a piece of the pie via a proposed new unit, the New York Futures Exchange.

The resulting "proliferation" of financial futures contracts—three exchanges already list Treasury bill futures and two more want to—has led to worries in Washington that unlimited expansion may be undesirable. Now, many commodity industry officials expect that officially or unofficially, there will be a moratorium on authorizations of new listings of financial futures.

"There certainly will be a silent moratorium," says one Chicago official, who doesn't mind at all that life will be made more difficult for his competitors in New York.

Officials note that Deputy Treasury Secretary Robert Carswell brought up the proliferation issue in two recent speeches. "This sudden surge in financial futures," he told one group of futures-industry leaders, "adds to our concerns that exchange self-regulation could weaken as each exchange seeks to promote its product." Increased trading in many commodity markets could put the "limited surveillance capabilities" of the Commodity Futures Trading Commission and the exchanges "under increasing pressure," he added.

Yesterday, a Treasury official denied the agency is seeking a "moratorium" on approvals of new financial futures contracts, but he repeated Mr. Carswell's belief that proliferation poses a "continuing problem."

Privately, Treasury officials have been more direct in stating their belief that the spread of financial futures should be slowed. The Treasury doesn't have regulatory authority over these instruments, but the agency appears to have at least a somewhat sympathetic ear in the form of CFTC Chairman James Stone.

"They haven't been specific about any harm that they believe has occurred," as a result of the spread of financial futures, says Mr. Stone, "but the very fact that they have an uneasiness would make me inclined to be cautious and to study any specific problems they might raise in the future."

Applications for new futures contracts already get a time-consuming examination at the CFTC, so observers interpret Mr. Stone's statement to mean delays will get even longer, pointing to a de facto moratorium. "The bureaucratic red tape is already being unrolled," says one observer.

Worried that its own applications for Treasury bill and bond futures may be delayed further, the New York Stock Exchange moved surprisingly on Friday to merge its still-unborn financial futures unit, known as the NYFE, with the American Stock Exchange's ailing financial futures unit, the Amex Commodities Exchange, or ACE.

The 18-month-old ACE never attracted substantial trading volume but it has obtained regulatory approval for the three most widely traded financial futures: Treasury bills, Treasury bonds and Government National Mortgage Association certificates, or Ginnie Maes.

Industry sources say the ACE has little to offer the NYFE besides its listings and a high Big Board source confirms the NYFE hustled to make the acquisition offer because of worries over a moratorium. "It's essential we have products other than just currencies to trade," he says. NYFE has applied to trade five foreign-currency futures and there appears to be less concern in Washington over trading duplication on currencies, analysts say.

The CFTC is far from uniformly sympathetic to the Treasury's concerns. Commissioner David Gartner is on record against them. Robert Wilmouth, president of the Chicago Board of Trade, the nation's largest futures marketplace, declares: "We've operated successfully for 130 years with self-regulation. The only problems have been in markets that aren't regulated."

Mr. Wilmouth sees "a continuing education program" as the answer to the Treasury's concerns, which many industry officials believe are founded on a general lack of information on who are the participants in financial futures markets and what their effects are.

$80-MILLION FSLIC BAILOUT SAVED GNMA 'DISASTER' FOR A DOZEN DEALERS

An unprecedented decision by the Federal Savings & Loan Insurance Corp. to bail out dealers and issuers in Government National Mortgage Assn. forwards may have rescued the Ginnie Mae industry from an "unmitigated disaster," according to officials close to the issue.

FSLIC will have paid out by week's end an estimated $80-million to 40 firms and institutions which sold stand-bys and reverse repurchase agreements to a Cleveland thrift called Washington Federal Savings & Loan Assn. Washington Federal, which was ordered by the Federal Home Loan Bank Board to merge in an effort to avoid liquidation, would have been forced to "walk away" from $600-million in outstanding commitments according to federal officials. The S&L had total assets, including deposits, of only about $200-million.

SECURITIES WEEK • March 31, 1980

Among the dealers which were at risk in the Washington Federal collapse, according to FHLBB documents, were Shearson Loeb Rhoades; Paine Webber; Oppenheimer & Co.; Donaldson, Lufkin & Jenrette, Bank of America, Cantor, Fitzgerald; Lehman Government Securities; Thomson McKinnon, and Bateman, Eichler, Hill, Richards.

Washington Federal also purchased Ginnie Mae forwards directly from the originators of the loans, and a score of major mortgage bankers, brokers, and savings and loans were also bailed out by FSLIC. They included Merrill Lynch, Huntoon, Paige Inc., Wells Fargo Mortgage, Mellon National Mortgage and North Federal Savings and Loan, New York.

The Washington Federal incident was the first known time that FSLIC had ever moved to protect Ginnie Mae dealers who were creditors of a failed S&L. FSLIC officials say, however, that it is not unusual for the insurer to pay off creditors other than depositors. In this case and in other supervisory mergers, the acquiring thrift accepted the assets and some liabilities of the failed institution, but major liabilities were absorbed and paid off by FSLIC.

Both street and government observers say that the Washington Federal collapse could have triggered a disaster among already reeling government securities dealers. "You would have seen more than one firm go under," said one observer, "if the feds didn't bail them out."

FSLIC plans to hold on to the contracts they are buying, rather than liquidating the positions. Sources say if all the contracts were liquidated now, the total loss would be at least $139-million. By holding the contracts, FSLIC claims it can eventually reduce the portfolio loss to about $20-million.

Washington Federal officials insist the FSLIC action was premature and say they could have continued to do business.

American Banker

MAY 12, 1980

Agencies Seek GNMA Forward Mkt. Rules

Special to the American Banker

WHITE SULPHUR SPRINGS, W. Va. — The Treasury and Federal Reserve will recommend that the forward market for GNNA securities be somehow regulated to require margin maintenance and a mark to the market rule.

John Schmidt, deputy assistant Treasury secretary for debt management, did not say if the rules should be uniform and did not provide other details. He did say, however, that regulation would be contined at least initiallv to the forward market for mortgage-backed securities and not be extended to the Treasury cash market or the money markets.

Mr. Schmidt told the Public Securities Association that he was "suprised, given the tales of woe," that the problems revealed in the joint study by the Treasury, Federal Reserve, and Securities and Exchange Commission were "relatively few and in fact most involved actual frand that no regulation would have prevented."

Likewise, he said after his speech, "it is crystaly clear that there are no problems in the cash market."

Mr. Schmidt did not say if the margin rules would be uniform for all participants in the forward market. But he emphasised that the lack of margin and market to the market standards is a glaring problem in the forward market.

Currently, a mosiac of credit standards only partly protects the industry from possible fails of large positions in the forward market. The Government National Mortgage Association required mortgage bankers to value their positions at market prices at least monthly. Numerous securities firms require margin from customer whose positions exceed credit limits set by the securities firm. Also, more than two dozen dealers, brokers, and mortgage bankers who belong to the Mid Mortgage Backed Securities Clearing Corp. adhere to margin rules and mark to the market provisions that are applied daily. The clearing corporation nets trading only among its members and provides each with a daily statement of its net position with other members. However, this patchwork approach to margin requirements and valuing positions at market value "is a paper tiger," according to Roger Shea, chairman of PSA Self Regulation Inc. Mr. Shea, who is also a senior vice president at Merrill Lynch, says that uniform margin rule and mark to the market provision is needed for the industry.

The Treasury intends to increase its vigilance of the futures markets, Mr. Schmidt said. He noted that it is the issuer of the commodity underlying many futures contracts.

He observed that many market participants contend the futures markets helped the Treasury by enabling more firms to take positions in the cash market market they were hedged by futures contracts.

On the other hand, the Treasury is still concerned about the ill effects of duplicating of contracts, possibly inadquate deliverable supply, and tax-motivated trading. He observe that in cases such as that of a recent 90-day Treasury bill issue, where 50% of the issue was required for delivery against futures contracts, "the Treasury does not know if this is good or bad, only that it is significant.

Mr. Schmidt asked if the "futures tail is wagging the cash dog," as some market prticipants have claimed.

The Treasury is also studying a recent proposal of the Chicago Board of Options Exchange to start trading of options on some government securities. ■

Interest Rate Futures Appeal To Banks as Earnings Stabilizers

By JOHN YOCH

NEW YORK — The casual observer on the trading floor of Commodity Exchange, Inc. here sees a situation that is best described as mayhem.

Brokers and traders gather in trading pits where they exchange contracts for future delivery of a commodity at a specified price. Buying and selling occurs though the "open outcry" method to protect competition of the marketplace, and the trading often resembles a shouting match.

In the current era of volatile interest rates and economic uncertainty, however, bank officers increasingly see the organized chaos at trading floors such as Comex in a different light. Interest-rate futures contracts are gaining popularity as a means to stabilize bank earnings.

For Stephen V. Weidemann, vice president and manager for Marine Midland Bank here, these contracts can help maintain the feasibility of fixed-rate lending, endangered recently by the prospect of recurrence of sharply rising interest

(See FUTURES on Page 31)

MAY 19, 1980 **American Banker**

Futures . . . .

(Continued from page 1)

rates on short-term liabilities.

Speaking recently to a seminar on financial instrument futures sponsored by the Bank Administration Institute and hosted by Comex, Mr. Weidemann said that use of futures contracts is "not a panacea, but a tool" which must complement management of the asset-liability mix.

Mark Polanis, vice president and director for the BAI's financial services group, said hedging through interest rate futures is "the way of the future for bankers."

The futures market will help bankers protect the "funding profit" obtained by lending at yields higher than those on their borrowings, by allowing them to transfer interest-rate risk to those more willing to accept it. But bankers must understand that the funding profit is reduced along with risk, Mr Polanis said.

Can Hedge Mismatches

Futures contracts enable banks to hedge maturities mismatches between assets and liabilities more quickly than they can through changes in the balance sheet, Mr. Polanis said.

But Mr. Polanis emphasized that banks should use futures only to hedge specific mismatches and not to speculate. This is also the policy behind regulations enacted this year by the Comptroller of the Currency.

Under these regulations, national banks' boards of directors must set strict guidelines for using futures contracts and must submit the guidelines to regional branches of the Comptroller's office. Prior approval by that office is no longer needed, however.

According to Scott Ryan, executive adviser for banking and securities for the Comptroller's Office, banks sometimes submitted inadequate guidelines when the office required prior approval.

Proposals often lacked limits on the total amount of futures contracts purchased and guidelines for matching contracts with corresponding mismatches. "Some of the junk we got was absolutely appalling," Mr. Ryan said.

Jack W. Parker, senior vice president of Union Planters National Bank, Memphis, said futures contracts provide banks with a means to get through "transitional periods of volatile rates." Portfolio managers should use futures contracts to avoid making two common mistakes.

Unnecessary Liquidity Increases

One mistake occurs during periods when there is an inverted yield curve—when short-term rates exceed long-term rates. This occurs in a situation where loan demand is strong, interest rates are generally high, bank liquidity is depleted, and the Federal Reserve Board is tightening monetary policy, Mr. Parker said.

In this situation, portfolio managers often buy short-term securities because their yields are higher than those on long-term securities, he said.

This unnecessarily increases liquidity at a time when banks should expend it. Banks instead should buy long-term securities, locking in yields which are at their high point in the interest rate cycle, he said.

As the economy cools, short-term rates will fall below long-term rates. But by then long-term rates also have fallen, Mr. Parker said.

On the other hand, the portfolio manager who at the outset correctly decides to lock in a high long-term yield faces the problem of low liquidity, he said.

"It is a fact of life for commercial bank portfolio manager that when the highest relative yields are available, he has the smallest amount of funds available for investment," Mr. Parker commented.

A bank then would probably have to fund a new long-term security by selling some assets at a loss. If it does not want to take such a loss for tax purposes, it could instead use a U.S. Treasury bond futures contract and fund the new security when some existing assets mature, Mr. Parker explained.

Buy Hedge

This would be a "buy hedge," or a contract to take delivery of a bond at a fixed price. As rates decline, bond prices rise and increase the contract's value.

If a new security has risen in price by the time that enough assets mature to fund its acquisition, the cost increase is offset by the profit made on the futures contract. This enables the bank to "lock in" the security's original high yield by "pre-investing," said Mr. Parker.

When interest rates are in the trough of their cycle, portfolio managers often make another type of mistake. Banks have ample liquidity, rates are generally low, and long-term rates exceed short-term rates. The Fed then tends to use stimulative monetary policy.

Portfolio managers in this situation should keep asset maturities short in order to build liquidity for an upswing in business. But the present lack of loan volume creates the temptation to buy long-term securities so that their higher yields will boost income, Mr. Parker said.

As interest rates begin rising, however, bond prices will fall. A bank purchasing long-term bonds when interest rates are in their trough probably would have to resell the bonds at a loss to maintain liquidity as loan demand picks up, he said.

In order to obtain the higher long-term yields without jeopardizing liquidity, the bank can use a "sell hedge"—a contract to deliver a security at a future date at a specified price, he said.

As bond prices decline, the contract's price rises and offsets the price decline on a security. The bank can then sell the security to fund other assets as loan demand picks up, or it can puchase a long-term security with a higher yield.

THE NEW YORK TIMES, MONDAY, MAY 19, 1980

Commodities

H. J. Maidenberg

Financial Futures as Barometer

THE futures markets for financial instruments apparently anticipated the $3.3 billion increase in the nation's money supply last week, as they underwent an abrupt reversal on Friday.

Before the Federal Reserve Board announced its weekly figures, the price of the spot June Treasury bill futures had plunged the daily permissible limit of 50 basis points, each point representing $25 per contract of $1 million. Considering that the speculative initial cash margin required to carry a Treasury bill contract is about $1,000, many of those with long positions should be getting calls for additional margin this morning.

For the week, June Treasury bill futures closed at 90.80 ($908.00 for each $1,000 of face amount), down 25 points, or $625, a contract. The price of the equally sensitive spot June Treasury bond futures also reversed course Friday, closing down 17/32, at 78 7/32. Each 32d of a point in Treasury bonds equals $31.25 per contract of $100,000. The spot Treasury bond delivery lost a stunning 3 3/32, or $2,093.75, on the week, substantially more than the required initial margins in that market.

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Market analysts said there were not any leaks from the Fed. They said these "interest rate futures" have become most sensitive barometers of the money market as well as "the ultimate commodities" because their prices reflect the actual value of money.

At midday last Thursday, Donald M. Selkin, market strategist in the managed commodity accounts department at Merrill Lynch, Pierce, Fenner & Smith Inc., said in an interview: "The interest rate futures are clearly signaling a major reversal. Treasury bill and Treasury bond prices are going to break today; everyone in the Street knows the money is going to be increased significantly."

By the close that day, Treasury bill futures prices were down the daily permissible limit of 50 basis points, and Treasury bonds plunged their limit of two full points.

Discussing the reversal in interest rate futures, Mr. Selkin said: "These financial futures are the most sensitive indicators of money market conditions because dealers in Treasury issues, bankers, insurance companies, pension funds and other institutions are increasingly using the futures as hedging mechanisms. Thus, the slightest changes in portfolios and buying and selling patterns are immediately reflected in financial futures prices."

Looking at his interest rate charts, Mr. Selkin noted that when the Federal Reserve further tightened credit in early February as part of its anti-inflation campaign, which sent interest rates soaring, prices of all financial instruments fell and their yields rose accordingly as investors took advantage of higher-yielding competitive debt issues, such as commercial paper and money market funds.

As a result, Treasury bill prices plunged to the point that the 90-day paper produced a record yield of 15.7 percent. Because bills carry no interest and are sold on a discount basis from face value, a yield of 15.7 percent meant that these debt issues were selling as low as 84.30 cents on the dollar.

Another factor that was slashing prices of Treasury bills then was that the cost of financing positions was between five and seven percentage points above that record yield, the prime rate then being as high as 20 percent.

• • •

But by late March, Mr. Selkin recalled, institutional and other investors found indications that the Fed wanted to halt the rise in interest rates, perhaps so as not to strangle the economy. The money managers then rushed back to buy Treasury debt issues to lock in the then-high yields because they saw the demand for credit was slackening, and competitive rates dropping. The result was that Treasury bill prices, for instance, took off in a straight line upward, with yields plunging accordingly.

In a recessionary climate, Mr. Selkin pointed out, "there is usually a flight to quality because a shadow of doubt tends to spread over the i.o.u.'s issued by private corporations."

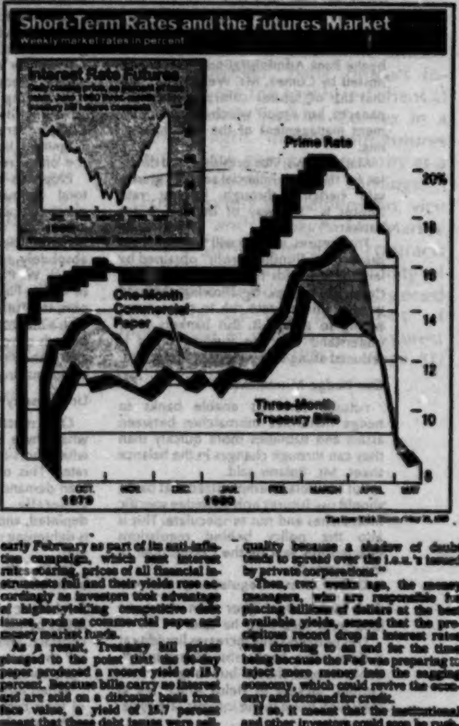
Then, two weeks ago, the money managers, who are responsible for placing billions of dollars at the best available yields, sensed that the precipitous record drop in interest rates was drawing to an end for the time being because the Fed was preparing to inject more money into the sagging economy, which could revive the economy and demand for credit.

If so, it meant that the institutional and other investors could soon be rushing out of Treasury debt issues and into competitive yielding instruments. Late last week, the plunging prices of Treasury issues supported that view; so did the record rise in the money supply announced after the close Friday.

• • •

Mr. Selkin observed that his recounting of the recent trends in interest rates only touched on the main points of what is a highly complex market. "For example, we saw short-term rates far above those on longer maturities, which is a definite aberration," he said. "Now we are seeing the yield curve return to a more normal pattern, signaling that future rates will be higher than current ones."

The Commodity Research Bureau index of futures prices (1967=100) closed last Friday at 287.9, off from 288.9 a week earlier. The index stood at 242.6 a year ago.



Short-Term Rates and the Futures Market

Weekly market rates in percent

The New York Times/May 19, 1980

JUNE 9, 1980 American Banker

Securities

Fed Proposes T-Bill Futures Changes

NEW YORK — The Federal Reserve Board has recommended changes in existing Treasury bill futures contracts to increase the deliverable supply of bills and to avoid distortions in Treasury bill rates just prior to delivery dates of futures contracts.

The Fed has previously voiced its approval for increasing the deliverable supply, but it had not said before that the cash market for bills was being distorted. Currently, market participants note that as of June 5, there was an exceptionally large open position of $4.38 billion for the International Monetary Mart's June three-month bill contract. While that open position is expected to be reduced subtantially as the June 19 delivery date nears, observers say that a larger than normal amount of bills should be needed for delivery to holders of the contracts.

In a letter to the Commodity Futures Trading Commission, the central bank again suggested that deliverable supply be increased to include more than just one bill issue in a contract month. It also noted that deliverable supply could be increased by allowing delivery of previously issued one-year bills which have a maturity near that of regular 13- and 26-week bills. Treasury officials are also on record as concerned about the potential for a lack of supply to accommodate futures contracts.

The Treasury and Fed have not opposed the development of the futures markets, but have urged the markets to broaden deliverable supply and curb duplication of contracts. In one study of the futures markets the Treasury and the Fed, acknowledged that the futures markets may help transfer risks and increase the debt markets' efficiency.

Hedging Positions

Last winter and spring, when interest rates were rising sharply, several observers noted that securities dealers were able to continue cash market trading and underwriting largely because they were hedging their postions in the futures markets.

In its letter to the CFTC, the Fed said that "over the past year or so the T-bill yield curve appears to have been pulled out of alignment in the week to two week period preceding the delivery dates" of the IMM three-month bill futures contract. That distortion may be related to position taking in the cash market in preparation of the anticipated heavy volume of actual deliveries, the Board said. Rates for Treasury bills that are deliverable for the IMM contract have been 10 to 20 basis points lower than rates for adjacent bill maturities, the Fed said.

The Federal Reserve also recommended that the CFTC approve the New York Futures Exchange's application for Treasury bond and bill futures if the merger between NYFE and the American Commodities Exchange is accomplished.

To avoid excessive duplication of contracts the Board wants to be certain that the existing ACE bond and bill futures contracts are retired before NYFE trading starts.

The CFTC is scheduled to vote in July on whether or not to approve trading of the NYFE contracts.

FINANCIAL MARKETS

How banks are hedging on rates

With U.S. interest rates seesawing at their wildest pace ever, the nation's banks are flocking to the financial futures markets in steadily growing numbers. Indeed, the chance to protect both their fixed-income inventory and their mortgage positions against massive losses by hedging with U.S. Treasury bills, Treasury bonds, and Government National Mortgage Assn. certificates has thrust bankers into much the sort of commercial hedging role that a General Mills Inc. plays in the grain markets to protect itself against grain price movements. "Financial instrument futures are probably the biggest development in banking since the negotiable certificate of deposit," says Rufus F. Land, a senior vice-president of North Carolina National Bank in Charlotte. At the Chicago Board of Trade, for example, May volume in Treasury bond futures soared to 520,493 contracts, a 186% increase from a year earlier.

Despite the rush, the path to the market has not been smooth, since most bankers until recently viewed the futures market as a highly speculative arena. Moreover, most large banks have numerous options for managing their rate exposure, such as using floating-rate loans or altering the maturities of certificates of deposit. But industry officials agree that the 50 or so banks active in the market—including Chase Manhattan, Morgan Guaranty, and Citibank—represent just the first trickle of a flood of institutions that will follow.

Burden of proof. The Federal Reserve Board's Oct. 6 credit-tightening moves have already opened the spigot a little wider. Numerous banks that were unhedged last fall—and essentially betting on a drop in interest rates—found themselves stuck with unprofitable fixed-rate loans. Thus, profits took a beating. "The burden of proof is now on the banker who is not using futures, rather than the banker who is," asserts an official of a large New York bank. Adds Mark F. Polanis, financial services director of the Bank Administration Institute, based in Park Ridge, Ill.: "The ground swell of interest in futures is a belated acknowledgment of the market's potential to hold the line on interest costs."

Further complicating the task of handling interest rate risk are the wrenching changes the banking industry is currently undergoing. These changes include the six-year phaseout of Regulation Q, which had insulated banks from higher costs of funds by imposing a ceiling on interest rates paid to depositors, and the advent of high-yielding money market mutual funds and CDs. Meanwhile, businesses have continued to demand fixed-rate credit. "Financial institutions face the prospect of absorbing a great deal of interest rate risk, and the futures market represents a means of transferring that risk to someone who is willing to take it on," says J. Mikesell Thomas, a vice-president at First Chicago Corp. "Futures are not a panacea, but they certainly can be a helpful tool."

That clearly was the case last fall at North Carolina National Bank, which in September purchased $10 million worth of six-month Treasury bills in the cash market. In the days preceding the Fed's Oct. 6 tightening, however, rumors about the upcoming Fed action spurred North Carolina National to sell Treasury bill futures twice to protect its cash market position. Consequently, when the bank closed out both its cash and futures positions on Oct. 4, it had lost $4,500 in its Treasury bill cash transactions, but it had gained $21,000 from its futures hedges. The net profit was $16,500. "These types of dealings go on continuously and, when taken together, can mean substantial savings," says Craig M. Wardlow, a senior vice-president at the bank. With interest rates falling, banks now are looking at the opportunity to purchase futures contracts to lock in high yields before rates move lower.

'You bet your boots.' In addition to protecting their investment portfolios, some banks are also hedging their mortgage activities. At Continental Illinois National Bank & Trust Co. of Chicago, for example, the Real Estate Dept. buys and sells mortgages, earning a service fee. "During the time we own these mortgages, we hedge them with Ginnie Mae futures," says David G. Taylor, executive vice-president of bond and money market services. "Last year, in a period of rising interest rates, that was worth literally millions and millions of dollars to us."

The bankers' new fondness for the market has not gone unnoticed by feder-

Investment figures of the week

The week saw at least a pause in the long and dramatic decline in interest rates as the cheaper money brought a mob of borrowers into the market. As interest rates went higher, the rally in the stock market stalled.

	Latest week	Previous week	Previous month	Year ago
Money market rates				
Federal funds	11.00%	9.50%	11.57%	10.19%
New three-month Treasury bills	8.00%	7.60%	8.73%	9.52%
New six-month Treasury bills	8.17%	7.75%	8.93%	9.44%
Three-month commercial paper	8.80%	8.05%	11.50%	9.93%
Stocks				
Price/earnings ratio* (avg. 1,500 stocks)	7.84	7.90	7.43	8.22
Dividend yield* (avg. 1,500 stocks)	5.45%	5.50%	5.74%	5.10%
Dow Jones industrial average	860.77	867.76	816.94	851.34
Standard & Poor's 500 stock index	110.51	111.40	106.25	100.62
Value Line composite index	119.57	120.00	113.66	110.61
Lipper growth mutual fund index	128.04	130.25	116.77	101.30
Average daily NYSE volume (millions)	39.2	40.6	33.1	26.5
NYSE blocks (10,000 shares and over)	475	690	446	342
Bonds				
New Aaa utilities	11.30%	11.17%	11.20%	9.54%
New Baa utilities	13.26%	13.20%	13.25%	10.75%
New Aa industrials	11.20%	10.85%	10.78%	9.40%
U.S. governments (8¼% issue of 1984-88)	10.23%	10.10%	10.15%	9.03%
Bond Buyer municipals (20-bond index)	7.75%	7.87%	7.90%	6.10%

All figures are as of Tuesday, June 3—except those marked*, which are from Friday, May 30, and the Bond Buyer index from Thursday, May 29, 1980.

Data: Salomon Bros., Standard & Poor's Compustat Services Inc., Lipper Analytical Services Inc.

al regulators, who worry that banks might get in trouble by speculating with futures or, even worse, relying on the futures to cover up operating mistakes. "The banks that get hurt these days play a game called 'You bet your bank.' They roll the dice, try to pick a peak in rates, and risk their bank's capital in the process," warns Owen Carney, a banking operations director with the Comptroller of the Currency. "The real danger is the temptation to do that, and then try to hedge away the risk in the futures market. Futures may slow the bloodletting, but it will exist nonetheless."

Futures proponents counter that appropriate controls—such as trading limits, strict reporting procedures, and internal audits—will eliminate possible abuses. "In fact, the decision not to hedge is a de facto decision to speculate," contends Richard L. Sandor, a vice-president with ContiCommodity Services Inc. in Chicago. Still, even the most ardent advocates concede that hedge transactions in financial instrument futures are highly complex and involve a degree of risk.

Meanwhile, further growth in bank participation looms on the horizon. The accounting profession is drawing up standardized techniques for banks using financial futures, and additional contracts—for both domestic and Eurodollar CDs—await approval from the Commodity Futures Trading Commission. "The market is evolving, and certain problems exist. But by the end of the 1980s, it is likely that banks will be routinely working with interest rate futures," predicts Polanis of the Bank Administration Institute. ■

34 THE WALL STREET JOURNAL, Wednesday, June 18, 1980

Squeeze in Futures Trading of Treasurys Poses Nightmare for U.S. Policymakers

By Roger Lowenstein
Staff Reporter of THE WALL STREET JOURNAL

For a while this month, it looked as though a monetary policymaker's nightmare might come true. Some experts worried there wouldn't be enough Treasury bills available tomorrow to meet delivery obligations for them in futures markets.

During the past year, trading in Treasury bill futures has increased much more rapidly than the supply of the bills issued by the Treasury. There have been temporary shortages in other commodity markets, such as silver and wheat, but a shortage of Treasury bills could have more serious consequences: It would drive up their prices, thereby reducing interest rates on a key short-term government obligation.

As custodian of the nation's monetary policy, the Federal Reserve Board prefers that interest rates move because of supply and demand for money, rather than the whims of commodity traders. The Treasury has its own cause for concern: In a more volatile bill market, investors would seek higher interest rates to justify the increased risk, thus increasing the government's borrowing cost in the long run.

"The last thing we want," a Treasury official says, "is for bill dealers to get crowded out by people clamoring to make deliveries on the futures market."

Qualms on Futures' Growth

It currently appears there will be more than enough bills to go around tomorrow, when deliveries are due against expiring June futures contracts. But a look at events that preceded this routine outcome shows why both the Fed and the Treasury have qualms about the rapid growth of financial futures.

A shortage didn't occur this time, "but the way the market has been growing one day there will be a squeeze" on supplies of Treasury bills, says Stan Jonas, director of financial futures for Acli International Commodity Services Inc., a commodities firm.

Like futures on wheat, gold or pork bellies, Treasury bill futures are contracts covering the delivery of the commodity at a specified price, place and future time. Bill futures are traded mainly on the Chicago Mercantile Exchange, where trading volume in them nearly tripled in the first five months this year from a year earlier to 1.4 million contracts covering $1.4 trillion in Treasury bills. Each contract covers $1 million of bills.

Usually, futures traders close out their positions before delivery is due, settling for cash profits and losses. Traders committed to buy, for instance, sell an equal amount to cancel their obligations.

But as late as June 5, contracts covering $4.38 billion in Treasury bills for June delivery remained outstanding on the Merc, alarming some traders.

Commodity specialists estimated there would be $6.9 billion of 90-day bills available for delivery against those contracts. The supply includes 90-day bills auctioned Monday and six-month bills auctioned March 17, which have three months of life remaining.

However, an unknown, but sizable, portion of the available bills are in the hands of the Fed, which probably wouldn't make them available to ease a futures squeeze, and of foreign banks and small investors unlikely to sell them to Merc traders.

Reflecting the tight balance between supply and demand, the price of June contracts rose to a premium compared with September contracts, the opposite of the usual relation. Both prices have risen sharply in recent months as interest rates plunged, but commodity traders say June bill futures were strong also because some big traders bought large amounts of them.

"It didn't get to the point where someone had cornered the market," one Merc trader says, "but there definitely was a squeeze on. A couple of local players had built up large positions and people were afraid they meant to take delivery."

Joel L. Greenberg, a vice president of Heinold Commodities Inc., and Tom Dittmer, chairman of Ray E. Friedman & Co., are two Chicago commodity-firm executives who were cited frequently as heavy buyers of June bills. Asked whether that were so, Mr. Dittmer said, "It depends what you call a lot."

Order of $1 Billion

An associate of Mr. Greenberg says the Heinold official was "very bullish" on bills for June delivery. Other traders go further: They say Mr. Greenberg stunned the market by recently placing an order for $1 billion of bill futures.

However, as June progressed, the big traders and others reduced their holdings so contracts covering only $1.58 billion of bills remained outstanding Monday. The threat of a shortage thus has abated.

Nonetheless, some concern remains. "The futures markets create an opportunity for some sharp operators to make a buck," a Fed official says. For its part, the Merc has applied for regulatory permission to amend its rules so the same Treasury bills can be used to satisfy more than one futures contract, thus reducing the possibility demand may exceed supply.

Savings Bank Reports $33 Million Loss in Trading

By ROBERT A. BENNETT

The Greater New York Savings Bank, one of the largest savings banks in the city, had an exceptional loss of almost $33 million in April, May and June as a result of speculation in Government-insured mortgages, according to a report it filed with the New York State Banking Department.

In an effort to save the institution from possible failure, banking sources said yesterday, state and Federal banking authorities intervened and set off a series of extraordinary changes at the bank.

These included the departures of the chief executive officer and an executive vice president, the dismissal of one accounting concern and its replacement by another, and the demand that the bank quickly unwind its speculative positions. Other dismissals are expected.

State regulatory officials stressed that at this time the bank was in no danger of failing. The bank's June 30 report showed that, even after the large loss, the assets of Greater New York Savings exceeded its liabilities by more than $100 million.

The banking sources, however, said that the accuracy of the bank's figures would not be confirmed until an audit now under way was completed.

Deposits of up to $100,000 are insured by the Federal Deposit Insurance Corporation, a Government agency.

The report filed with the State Banking Department showed that, in the second quarter of the year, Greater New York Savings lost more than $40 million on sales of mortgages that were insured by the Government National Mortgage Association. Other activities reduced the bank's total loss for the quarter by about $7 million.

The losses occurred as a result of the

Continued on Page D9, Column 1

For Home delivery of The New York Times, call toll-free [illegible]. In New Jersey: [illegible]. In Boston, call (617) [illegible]—ADVT.

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Continued From Page 1, Section 1

sharp climb in interest rates in the last quarter of 1980 and the first quarter of 1981. Last year Greater New York Savings began making commitments to purchase the mortgages, known as Ginnie Maes, the sources said. At one point, according to these sources, these commitments amounted to about $1 billion, or about [illegible] the bank's total assets of $1.7 billion.

If interest rates had dropped, as Greater New York Savings had expected, the bank would have made large profits. Instead, however, interest rates rose sharply and the market value of the mortgages dropped considerably. Instead of selling out early and cutting its losses, the bank kept [illegible] its position.

Robert [illegible] Cassaza, who had been president and chief executive officer, left the bank during the quarter. The [illegible] said yesterday that Mr. Cassaza was [illegible] until his retirement takes effect in October.

Mr. Cassaza has been replaced by [illegible] Kessman, who had retired as the bank's president in [illegible]. Mr. Kessman, who joined the bank as an office boy in 1928, remained on the board of trustees following his retirement. Mr. Kessman, who is 70, said yesterday that the 86-year-old Mr. Cassaza left because "he was getting old."

In addition to Mr. Cassaza, John T. [illegible], formerly the executive vice president who had responsibility for the bank's mortgage-trading activities, has left the bank.

During the quarter, according to the sources, the authorities forced the dismissal of Main, Hurdman & Cranstoun as the bank's accountants and Peat, Marwick, Mitchell & Co. has been named as the replacement.

Norton Solomon, national director of accounting and auditing for Main, Hurdman, acknowledged yesterday that the concern no longer served as the auditor for the bank. But Mr. Solomon cited the confidential relationship between accounting concerns and their clients and said "it would be inappropriate for us to comment" on the change.

Mr. Kessman said Greater New York Savings had the cash to repay all its borrowings by the end of June. He added that only one loan of $[illegible] million was outstanding. This loan, he said, was owed to the money brokerage concern of Lombard Wall Inc. of New York. Mr. Kessman said he wanted to repay the loan, which was secured by mortgages, to Lombard Wall on June 30, but that the concern said it would not have the collateral available until tomorrow, when the loan originally was to have been repaid.

Harold Kurtz, president of Lombard Wall, said last night that the loan was only for $33 million and that the collateral would be available tomorrow, when the loan payment becomes due.

The sources said that the situation at Greater New York Savings appeared to be well under control, but that this would not be absolutely certain until Peat, Marwick completed the audit it was conducting.

NY TIMES 16 July '80

Loss Forces Shifts At a Savings Bank

Continued From Page 1, Section 1

steep climb in interest rates in the last quarter of 1979 and the first quarter of 1980. Last year Greater New York Savings began making commitments to purchase the mortgages, known as Ginnie would decline, the sources said. At one point, according to these sources, these commitments amounted to about $3 billion, or about twice the bank's total assets of $1.7 billion.

If interest rates had dropped, as Greater New York Savings had expected, the bank would have made large profits. Instead, however, interest rates rose sharply and the market value of the mortgages dropped precipitously. Instead of selling out early and cutting its losses, the bank kept adding to its position.

Albert J. Casazza, who had been chairman and chief executive officer, left the bank during the quarter. His secretary said yesterday that Mr. Casazza was on "pre-retirement leave" until his retirement takes effect in October.

Mr. Casazza has been replaced by Manuel Kessman, who had retired as the bank's president in 1977. Mr. Kessman, who joined the bank as an office boy in 1928, remained on the board of trustees following his retirement. Mr. Kessman, who is 70, said yesterday that the 60-year-old Mr. Casazza left because "he was getting old."

In addition to Mr. Casazza, John T. Fischetti, formerly the executive vice president who had responsibility for the bank's mortgage-trading activities, has left the bank.

During the quarter, according to the sources, the authorities forced the dismissal of Main, Hurdman & Cranstoun as the bank's accountants and Peat, Marwick, Mitchell & Co. has been named as the replacement.

Morton Solomon, national director of accounting and auditing for Main, Hurdman, acknowledged yesterday that his concern no longer served as the auditor for the bank. But Mr. Solomon cited the confidential relationship between accounting concerns and their clients and said "it would be inappropriate for us to comment" on the change.

Mr. Kessman said Greater New York Savings had the cash to repay all its borrowings by the end of June. He added that only one loan of $50.2 million was outstanding. This loan, he said, was owed to the money brokerage concern of Lombard Wall Inc. of New York. Mr. Kessman said he wanted to repay the loan, which was secured by mortgages, to Lombard Wall on June 30, but that the concern said it would not have the collateral available until tomorrow, when the loan originally was to have been repaid.

Harold Kurtz, president of Lombard Wall, said last night that the loan was only for $35 million and that the collateral would be available tomorrow, when the loan payment becomes due.

The sources said that the situation at Greater New York Savings appeared to be well under control, but that this would not be absolutely certain until Peat, Marwick completed the audit it was conducting.

Charter's Mason: An industry leader in insurance by the end of the decade?

large part of the analyst community, many of whose members were predicting per-share earnings for 1980 of $12 to $15 per share vs. $12.94 in 1979. Yet things turned sour in the second quarter, as the rising cost of crude and its short supply combined with softening demand for gasoline, heating oil, and residual fuel. In early July, Charter announced that the earnings squeeze might have caused the company to lose as much as $5 million in the second quarter and would threaten third-quarter profits, too. Charter's stock plunged, while analysts scurried to slash their earnings projections for the rest of the year, several of them predicting as little as $6 to $8 per share. One bearish analyst looks for the stock, which sold at $50 per share late last year, to plunge even lower than its current $19 market price.

Big interest costs. The earnings pinch may put Charter under additional pressure to keep up with its mounting payments. More than half of its debt is at rates that float at ½% to 2% over prime. Overall, Charter was paying 16% to 17% interest on its debt in the first quarter. Moreover, 55% of what Charter calls "long-term debt" must be repaid by 1985, which means Charter will be scrambling back to the markets for financing again and again. Indeed, for these reasons, Charter is intent on extending maturities and changing more of its debt to fixed rates while piling on more equity to balance the capitalization. Proceeds from the current $50 million debt issue will be used to repay some bank loans that are currently secured by Charter's 8.2% investment in St. Joe Paper Co. and another security. And Charter, eager to plump up its equity, has been issuing so much preferred stock that it is up to the letter *O* in the alphabet in naming the various series. ■

FINANCIAL MARKETS

Wrangling to rule financial futures

In the mid-1970s, when a high-ranking Securities & Exchange Commission official learned that the brand-new Commodity Futures Trading Commission was ready to approve the trading of futures contracts in financial instruments, he snapped to a CFTC attorney: "You're messing around with our act. You guys are supposed to regulate stuff like pork bellies."

That outburst marked the opening salvo of what this summer is developing into a full-blown battle over which federal agency—the CFTC or the SEC, and possibly the Federal Reserve Board or the Treasury—will regulate the booming financial futures market. Any loss of power by the CFTC could lead to a tighter control of what is now the fastest-growing side of the whole futures industry, with trading in financial futures running 140% ahead of a year ago.

The latest—and perhaps most critical—round in the jurisdictional imbroglio is being played out in the federal courts. The question is whether the Chicago Mercantile Exchange and the Chicago Board of Trade, which together account for 73% of all futures trading, can list the same groups of contract months in Treasury bill and bond futures as the New York Futures Exchange, which is due to open on Aug. 7.

More significant, however, the issue provides a crucial test for the CFTC's exclusive jurisdiction of financial futures. Yet the test comes with the commission's reputation tarnished by the less-than-decisive handling of the silver-market crisis that climaxed in March. "If the CFTC loses this case, it will have a hard time convincing other government agencies it controls the market," declares Thomas A. Russo, a former CFTC official. "From a regulatory standpoint, the parties are playing with fire."

Backfire? The current conflict could backfire on the CFTC. Indeed, the SEC, the Fed, and the Treasury, all of which lost out in attempts to share the regulatory power over financial futures in 1978, are sure to capitalize on any setbacks the six-year-old CFTC suffers in the skirmish. Ironically, though, the exchanges have much to lose as well, and the CFTC has privately warned them they may end up being policed more tightly by a hodgepodge of agencies. "There's a territorial grab going on in Washington," says Robert K. Wilmouth, president of the Chicago Board of Trade. "If the CFTC is perceived as weak, we'll probably end up being regulated by two or three agencies. And that's exactly what we want to avoid."

The issue came to light on July 2 when

The Merc's Yeutter: To allow only the NYFE to trade some spreads is to grant a monopoly.

the Chicago Mercantile Exchange, or "the Merc," added the "January cycle"—January, April, July, and October delivery months—to the four Treasury bill contract months it was already trading. The Merc ignored the CFTC's request that it drop the new months. Against similar objections, the Board of Trade began trading Treasury bond futures on July 11 in the new delivery months of February, May, August, and November. The CFTC had intended to earmark these contract months for trading on the New York Futures Exchange (NYFE). But that plan has brought only resistance from the other exchanges. Charges Merc President Clayton Yeutter: "For the CFTC to allow only [the] NYFE to trade these months is tantamount to granting them a monopoly."

In the courts. Ever since the Chicago exchanges flouted the CFTC's authority, the legal maneuvering has been furious. On July 14 a federal judge in Chicago issued a temporary restraining order prohibiting the Chicago exchanges from trading in the new months. But on July 16, just one day after the CFTC told the NYFE it could trade in the new months when it opens, a second federal judge in Chicago lifted the restraining order and ruled that the Chicago exchanges were entitled to the same rights as the NYFE. The CFTC has asked for a preliminary injunction. But the commission is also considering changing its rules to prevent an exchange from listing new months without explicit permission.

The CFTC contends that it is merely exercising its statutory authority over the Chicago exchanges, which it says cannot list new months without permission. The CFTC's stance also has been influenced by concerns of both the Fed and Treasury that trading the same month on more than one exchange might produce so much volume as to create shortages of Treasury securities at delivery time.

Confrontation. But the exchanges argue that their own rules, previously approved by the CFTC, permit the addition of new contract months at any time. Moreover, exchange officials say that potential supply problems could be overcome without resorting to a single-exchange mechanism. For example, Yeutter of the Chicago Mercantile Exchange proposes extending the delivery period for Treasury bills to three days from one day to increase deliverable supplies.

Congressional scrutiny of the CFTC has been intense since the silver episode. Indeed, Senator William Proxmire (D-Wis.), who heads the Senate Banking Committee, backs a bill that would shift the authority to set margins on financial futures and precious metals to the Fed.

Given the charged atmosphere in Washington, the Chicago exchanges are not oblivious of the dangers inherent in their fight against the CFTC. But competitors argue that the clout of a favored futures exchange backed by the powerful New York Stock Exchange would be even more damaging. "We will be sorry if this is the straw that breaks the CFTC's back," says Leo Melamed, special counsel to the Chicago Mercantile Exchange. "But this is such an important issue to us that we have to take the risk." ■

2. GUIDELINES

a. Letter and attachments from the Comptroller of the Currency, dated March 17, 1980

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

March 17, 1980

Ms. Barbara Timmer
Committee on Government Operations
Sub-Committee: Commerce, Consumer and
Monetary Affairs
U. S. House of Representatives
B-377 Rayburn, H.O.B.
Washington, D.C. 20515

RECEIVED
26
COM[illegible] AND
MONETARY AFFAIRS SUBCOMMITTEE

Dear Ms. Timmer:

This is in response to your request for information concerning regulation of bank participation in the interest rate futures markets and the resulting tax and reporting complications. We have enclosed copies of a training manual used in a recent class designed to instruct regional examiners in bank use of interest rate futures, forward placements and standby contracts. The lesson plan and examination programs dealing with futures are relatively straight forward. If you have any questions we will be happy to answer them for you.

The cornerstone to OCC's regulatory approach to interest rate futures is an accounting technique which forces current recognition of losses and gains. This type of accounting practice conflicts with Generally Accepted Accounting Practice, existing Internal Revenue rules and Securities and Exchange Commission reporting guidelines for banks. The accounting profession prefers deferred recognition of losses or gains when futures contracts are used in hedging strategies. SEC requires banks to report their financial operations in accordance with Generally Accepted Accounting Practice. OCC understands the theory of hedging and deferred accounting recognition but we refuse to accept the notion that individually hedged balance sheet items automatically reduce interest rate risks in a bank. The nature of banking, i.e. buying money at one price and selling it at another is a type of hedging; the introduction of futures contracts into an already hedged balance sheet may reduce interest rate risk or increase it. We think bank risk assumption via the futures markets can be limited if realistic accounting techniques are employed.

At present our requirement for banks to recognize futures or forward contract losses immediately, even if they take delivery of the underlying security, conflicts with IRS rules which only permit a loss recognition when the underlying security is disposed of.

If we can be of further help to you, please do not hesitate to call.

Sincerely,

Owen Carney
Director
Investment Securities Division

Enclosure

specific line entries to be made, refer to the call report instructions. Because these contracts are not investment securities, net losses or gains cannot be taken "below the line" as an investment security gain or loss.

b. Futures and forward contracts associated with the hedging of mortgage banking operations, i.e. the origination and purchase of mortgage loans for resale to investors or the issuance of mortgage-backed securities, may be accounted for in accordance with the generally accepted accounting principles applicable to such activity.

6. In the event the above described futures and forward contracts result in the acquisition of securities, such securities should be recorded on an accounting basis consistent with that applied to the contracts (either market or lower of cost or market). Acquisition of securities arising from standby contracts should be recorded on the basis of lower of adjusted cost (see item 7(c)) or market.

7. Fee income received by a bank in connection with the issuance of a standby contract should be deferred at initiation of the contract and accounted for as follows:

   a. Upon expiration of an unexercised contract, the deferred amount should be reported as income;

   b. Upon a negotiated settlement of the contract prior to maturity, the deferred amount should be accounted for as an adjustment to the expense of such settlement, and the net should be transferred to the income account; or

   c. Upon exercise of the contract, the deferred amount should be accounted for as an adjustment to the basis of the acquired securities. Such adjusted cost basis should be compared to market value of securities acquired. See item 6.

8. Bank financial reports should disclose in an explanatory note any futures, forwards and standby contract activity that materially affects the bank's financial condition.

9. To ensure that banks minimize credit risk associated with forwards and standby contract activity, banks should implement a system for monitoring credit risk exposure associated with various customers and dealers with whom operating personnel are authorized to transact business.

10. To ensure adherence to bank policy and prevent unauthorized trading and other abuses, banks should establish appropriate internal controls including periodic reports to management, segregation of duties, and internal audit programs.

BC- [illegible]

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: National Bank Participation in the Financial Futures and Forward Placement Markets

TO: Chief Executive Officers of All National Banks and Regional Administrators

This circular is a modification of the circular issued on November 16, 1979; it is effective January 1, 1980, and supersedes Banking Circular 79 dated November 2, 1976 and Banking Circular 79, Supplement 1 dated August 1, 1977, which are withdrawn.

This circular considers policies and procedures that should be initiated by national banks that engage in financial futures contracts, forward placement contracts or standby contracts in their commercial banking activities. We view these contracts as neither inherently prudent or imprudent. Evidence has shown that they can be used effectively to reduce interest rate risk. Any use of these contracts by national banks should be in accordance with safe and sound banking practices and with levels of activity reasonably related to the bank's business needs and capacity to fulfill its obligations under the contracts.

DEFINITIONS

Financial Futures Contracts. These contracts are interest rate futures, which under Section 2 of the Commodities Exchange Act, as amended (7 U.S.C. § 2) are commodities contracts traded on and guaranteed by a national exchange, registered with and regulated by the Commodities Futures Trading Commission (CFTC). These contracts represent a commitment to purchase (to take delivery by the "long") or to sell (to make delivery by the "short") a standardized amount of the deliverable grade security at a specified price during a specified delivery month in accordance with the exchange rules regarding delivery procedures.

Forward Placement Contracts. These contracts are over-the-counter contracts for delayed delivery of securities in which the buyer (long) agrees to purchase and the seller (short) agrees to make a delivery of a specified security at a specified price for future delivery. Cash market transactions other than "when issued" transactions, specifying delivery (settlement) in excess of thirty (30) days following the trade date shall be deemed to be forward contracts. Forward contracts are not traded on organized exchanges, the terms are not standardized, and the contracts can only be terminated by agreement of both parties to the transaction.

Standby Contracts. These are optional delivery forward placement contracts. The buyer of a standby contract (put option) pays a fee for the right or option to sell (deliver) an agreed upon amount of specified securities to the issuer of the standby contract at a specified price at a specified future date.

Date:

BC-[illegible] ([illegible])

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: National Bank Participation in the Financial Futures and Forward Placement Markets

GUIDELINES

These contracts are not considered investment securities within the meaning of 12 USC 24(7). However, with the distinctions described below for investment or non-dealer operations, asset-liability management, and dealer-bank trading activities, the use of these contracts is considered to be an activity incidental to banking. The following are minimal guidelines to be followed by national banks that engage in these markets.

1. Distinctions

   a. For investment portfolio or non-dealer operations in fixed rate assets, banks should evaluate the interest rate risk exposure resulting from their overall investment activities to insure that the positions they take in futures, forwards and standby contracts markets will reduce their risk exposure. Short positions in futures and forwards contracts should reasonably relate to existing or anticipated cash positions, and should be used to enhance liquidity of the portfolio. Rather than using short hedges against portfolio holdings for purposes of income generation, we would expect, where practicable, that contract gains would be used to offset losses resulting from the sale of portfolio securities as asset yields are upgraded. Long positions in futures and forwards should reasonably reflect the bank's investment strategy and ability to fulfill its commitments.

   b. Asset-liability management involves the matching of fixed rate and interest-sensitive assets and liabilities in order to maintain liquidity and profitability. Futures and forwards contracts may be used as a general hedge against the interest rate exposure associated with undesired mismatches in interest-sensitive assets and liabilities. Long positions in contracts could be used as a hedge against funding interest-sensitive assets with fixed-rate sources of funds; short positions in contracts could be used as a hedge against funding fixed-rate assets with interest-sensitive liabilities.

   c. Dealer-bank trading activities that employ futures, forwards and standby contracts should be in accordance with safe and sound banking practices reasonably related to the bank's legally permitted trading activities.

2. The Board of Directors should consider any plan to engage in these activities and should endorse specific written policies and procedures in authorizing these activities. Policy objectives must be specific enough to outline permissible contract strategies and their relationships to other banking activities. Recordkeeping systems must be sufficiently detailed to permit internal auditors and examiners to determine whether operating personnel have

Date:

BC-[illegible]

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: National Bank Participation in the Financial Futures and Forward Placement Markets

acted in accordance with authorized objectives. Bank personnel are expected to be able to describe and document in detail how the positions they have taken in futures, forwards and standby contracts contribute to attaining the bank's stated objectives.

3. The Board of Directors should also establish limitations applicable to futures, forwards and standby contract positions for each distinct category described in item 1 above. The Board of Directors, a duly authorized committee thereof, or the bank's internal auditors, should review all outstanding contract positions at least monthly and ensure that these limits are not exceeded.

4. Underlying security commitments relating to open futures and forwards should not be reported on the balance sheet. The bank should maintain general ledger memorandum accounts and commitment registers to adequately identify and control all commitments to make or take delivery of securities. Such registers and supporting journals should, at a minimum, include:

   a. The type and amount of each contract;
   b. The maturity date of each contract;
   c. The current market price and cost of each contract; and
   d. The amount of money held in margin accounts.

5. Accounting Requirements

   a. The market value of all open contract positions should be determined at least monthly regardless of whether the bank is required to deposit "margin" or a performance bond in connection with a given contract. Market values for forward and standby contracts should be based on the market value of the underlying security, except where published and widely distributed forward contract price quotations are available. All standby contracts should be marked to the lower of cost or market. However, losses on standby contracts only have to be computed by the issuer (the party committed to purchase under the contract) and only where the market value of the underlying security is below the contract price, reduced by the amount of the deferred fee described in item 7 below. All futures and forward contracts with the exception of contracts described in item 5b, should be valued by a consistent method of either mark to market or mark to the lower of cost or market. The Bank Board of Directors may choose which method of valuation (either market or lower of cost or market) if prefers and document it in the written policies and procedures described in item 2 above. All losses resulting from monthly contract value determination should be recognized as a current expense item; those banks that choose to value contracts on a mark to market basis would recognize gains as a current income item. For the

BC-79 (2nd Rev.)

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: National Bank Participation in the Financial Futures and Forward Placement Markets

The issuance of long-term standby contracts, i.e., those for 150 days or more, which give the other party to the contract the option to deliver securities to the bank will ordinarily be viewed as inappropriate. In almost all instances where standby contracts specified settlement in excess of 150 days, regulatory authorities have found that such contracts were related not to the investment or business needs of the institution, but primarily to the earning of fee income or to speculating on future interest rate movements. Accordingly, national banks should not issue standby contracts specifying delivery in excess of 150 days, unless special circumstances warrant.

National banks engaging in the futures, forwards and standby contracts markets must submit a copy of the specific written policies approved by the Board of Directors (see item 2 above), the established contract limitations (see item 3 above), blank internal recordkeeping forms (see item 4 above), and detailed descriptions of established internal controls (see item 10 above), to the Regional Administrator of National Banks for their region. We intend to monitor closely national bank transactions in futures, forwards and standby contracts to ensure that any such activity is conducted in accordance with safe and sound banking practices.

John G. Heimann
Comptroller of the Currency

Date:

Joint News Release

Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board

FOR IMMEDIATE RELEASE PR-27-80 (3-12-80)

REGULATORS ADOPT REVISIONS TO POLICY ON FUTURES, FORWARD AND STANDBY CONTRACTS

The three Federal bank regulatory agencies today announced a number of revisions in their guidelines for banks that engage in futures, forward and standby contracts on U. . Government and agency securities.

The changes announced today were to guidelines adopted last November. The Federal Deposit Insurance Corporation and the Federal Reserve Board incorporated the guidelines in a policy statement. The Comptroller of the Currency's guidelines were contained in an operating circular.

In one change, adopted by the FDIC and the Federal Reserve, futures and forward contracts executed by State-chartered banks before January 1, 1980, are exempted from the accounting procedures specified in the guidelines. The Comptroller of the Currency retained the January 1 effective date for all contracts entered into by national banks, as the Comptroller has had similar accounting provisions in effect since 1977.

Other principal changes in the guidelines adopted in the light of substantial comment received since the guidelines were published last November, include the following:

1. Banks may exercise the option of carrying futures and forward positions on a market or on a lower of cost or market basis.

2. Futures and forward contract activities associated with bona fide hedging of a mortgage banking operation are exempted from the otherwise prescribed accounting treatment for such contracts.

3. A number of other technical changes have been made, including relaxation of the requirement that a bank's board of directors review contracts at least monthly.

-more-

The agencies adopted the guidelines following a Treasury/Federal Reserve Study indicating that banks can effectively use financial futures contracts to hedge their risk of losses due to changes in interest rates, but noting that improper use of interest rate futures contracts increases, rather than decreases, the risk of loss due to changes in interest rates.

In addition to their guidelines, the agencies provided the following precautionary rules to banks they supervise:

1. Banks that engage in futures, forward and standby contract transactions should do so only in accordance with safe and sound banking practices.

2. Such transactions should be of a size reasonably related to the bank's business needs and to its capacity to fulfill obligations incurred.

3. The positions banks take in futures, forward and standby contracts should be such as to reduce the bank's exposure to loss through interest rate changes.

4. Policy objectives should be formulated in the light of the bank's entire mix of assets and liabilities.

5. Standby contracts calling for settlement in excess of 150 days should not be issued by banks except in special circumstances and ordinarily such long term standby contracts would be viewed by the agencies as being inappropriate.

The 10-point guidelines that should be followed by banks authorized to participate in these markets include directives on the role of bank boards of directors, record keeping, monitoring of such activities, valuation of contracts, treatment of fee income in connection with a standby contract, disclosures of activity by a bank in futures, forward and standby contracts, monitoring of credit risk exposure and internal controls at banks.

The text of the guidelines adopted by the three agencies, as contained in the policy statement of the FDIC and the Federal Reserve, is available from the FDIC Information Office.

# # #

Joint News Release

Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board

For immediate release November 15, 1979

The three Federal bank regulatory agencies today issued a joint policy statement setting forth precautionary rules and specific guidelines for commercial banks that engage in futures, forward and standby contracts for U.S. government and agency securities.

The agencies said the policy statement will become effective January 1, 1980 for contracts outstanding at that time and for those entered into subsequently.

However, the agencies also invited comment on the policy statement, through December 15, 1979.

The agencies noted this background to the general guidance they gave to commercial banks engaging in interest rate futures, forward and standby contracts on United States government and agency securities:

A recent Treasury/Federal Reserve study indicated that banks can effectively use financial futures contracts to hedge their risk of losses due to changes in interest rates, but noted that improper use of interest rate futures contracts increases, rather than decreases, the risk of loss due to changes in interest rates.

--The study also:

--Cited the experience of participants in financial futures markets who have been approached by salespersons who suggested speculative rather than hedging transactions.

--Indicated that some banks and other financial institutions have issued standby obligations for delivery of securities at predetermined prices in contracts that were so large they exposed the institutions to losses that could, and in some cases did, affect their financial condition.

The agencies' policy statement provided the following precautionary rules:

1. Banks that engage in futures, forward or standby contract transactions should do so only in accordance with safe and sound banking practices.

2. Such transactions should be of a size reasonably related to the bank's business needs and to its capacity to fulfill obligations incurred.

3. The positions banks take in futures, forward and standby contracts should be such as to reduce the bank's exposure to loss through interest rate changes affecting securities in the bank's investment portfolio.

4. Policy objectives should be formulated in the light of the bank's entire mix of assets and liabilities.

5. Standby contracts calling for settlement in excess of 150 days should not be issued by banks except in special circumstances and ordinarily such long term standby contracts would be viewed by the agencies as being inappropriate.

The policy statement also provided a 10-point set of guidelines that should be followed by banks authorized to participate in these markets. The guidelines--which may be found in the attached agencies' policy statement--included directives on the role of bank boards of directors, record keeping, monitoring of such activities, valuation of contracts, treatment of fee income in connection with a standby contract, disclosures of activity by a bank in futures, forward and standby contracts, monitoring of credit risk exposure and internal controls at banks.

The agencies said they will closely monitor bank transactions in financial futures, forward and standby contracts and that, depending on what this monitoring discloses, they might find it necessary to establish position limits or take other supervisory precautions against unsafe or unsound practices.

The agencies said that they may issue a similar policy statement for bank trust departments and trust companies at a later time.

The text of the agencies' policy statement is attached.

# # # #

FEDERAL RESERVE SYSTEM

Policy Statement Concerning Forward Placement or Delayed Delivery Contracts and Interest Rate Futures Contracts

[Docket No. R-0261]

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Policy Statement.

SUMMARY: This policy statement contains policies and procedures that the Board of Governors believes should be instituted by State member banks that engage in interest rate futures contracts,1/ forward contracts2/ or standby contracts,3/ on U. S. government and agency securities to insure that such activities are conducted in accordance with safe and sound banking practices. The policies and procedures will apply to outstanding contracts as well as those entered into after January 1, 1980. Similar policy statements are being adopted by the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

DATE: The policy statement is effective January 1, 1980. Comments, however, will be received until December 15, 1979.

1/ Futures Contracts: These are standardized contracts traded on organized exchanges to purchase or sell a specified security on a future date at a specified price. Futures contracts on GNMA mortgage backed securities and Treasury bills were the first interest rate futures contracts. Several other interest rate futures contracts have been developed, and it is anticipated that new and similar interest rate futures contracts will continue to be proposed and adopted for trading on various exchanges.

2/ Forward Contracts: These are over-the-counter contracts for forward placement or delayed delivery of securities in which one party agrees to purchase and another to sell a specified security at a specified price for future delivery. Contracts specifying settlement in excess of 30 days following trade date shall be deemed to be forward contracts. Forward contracts are not traded on organized exchanges, generally have not required margin payments, and can only be terminated by agreement of both parties to the transaction.

3/ Standby Contracts: These are optional delivery forward contracts on U. S. government and agency securities arranged between securities dealers and customers and do not currently involve trading on organized exchanges. The buyer of a standby contract (put option) acquires, upon paying a fee, the right to sell securities to the other party at a stated price at a future time. The seller of a standby (the issuer) receives the fee, and must stand ready to buy the securities at the other party's option.

FOR FURTHER INFORMATION CONTACT: Robert S. Plotkin, Assistant Director, or Michael J. Schoenfeld, Senior Securities Regulation Analyst (202/452-2782), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D. C. 20551.

ADDRESS: Comments should be addressed to Theodore E. Allison, Secretary of the Board, Board of Governors of the Federal Reserve System, Washington, D. C. 20551. Comments should contain Docket No. R-0261.

SUPPLEMENTARY INFORMATION: This policy statement is issued pursuant to the Board's supervisory authority over State member banks contained in section 9 (12 U.S.C. §321 et seq.) and section 11 (12 U.S.C. §248) of the Federal Reserve Act and the Financial Institutions Supervisory Act of 1966 (12 U.S.C. 1818 (b)) and related provisions of law.

Statement of Policy Concerning Forward Contracts and Futures Contracts

The following is a Board policy statement relating to State member bank participation in the futures and forward contract markets to purchase and sell U. S. government and agency securities. Information contained below is applicable specifically to commercial banking activities. An additional statement of policy applicable to trust department activities of State member banks may be issued at a later time.

The staff of the Treasury Department and the Board of Governors of the Federal Reserve System recently completed a study of the markets for Treasury futures. In part, the study notes that there is evidence that financial futures can be used by banks effectively to hedge portions of their portfolios against interest rate risk. However, the study also cautions that improper use of interest rate futures contracts will increase interest rate risk - rather than decrease such risk. In addition, various participants have advised that certain salespersons are attempting to suggest inappropriate futures transactions for banks, such as taking futures positions to speculate on future interest rate movements. Furthermore, some banks and other financial institutions have recently issued standby contracts (giving the contra party the option to deliver securities to the bank at a predetermined price) that were extremely large given their ability to absorb interest rate risk. In so doing, these institutions have been exposed to potentially large losses that could (and sometimes did) significantly affect their financial condition.

Banks that engage in futures, forward and standby contract activities should only do so in accordance with safe and sound banking practices with levels of activity reasonably related to the bank's business needs and capacity to fulfill its obligations under these contracts. In managing their investment portfolio, banks should evaluate the interest rate risk exposure resulting from their overall activities to insure that the positions they take in futures, forward and standby contract markets will reduce their risk exposure. Pairing a transaction in the spot market with an offsetting position in either futures, forward or standby contracts can be an effective way to reduce interest rate risk. However, policy objectives should be formulated in light of the bank's entire asset and liability mix. The following are minimal guidelines to be followed by banks authorized under State law to participate in these markets.

1. Prior to engaging in these transactions, a bank should obtain an opinion of counsel or its State banking authority concerning the legality of its activities under State law.

2. The board of directors should consider any plan to engage in these activities and should endorse specific written policies in authorizing these activities. Policy objectives must be specific enough to outline permissible contract strategies and their relationship to other banking activities, and record keeping systems must be sufficiently detailed to permit internal auditors and examiners to determine whether operating personnel have acted in accordance with authorized objectives. Bank personnel are expected to be able to describe and document in detail how the positions they have taken in futures, forward and standby contracts contribute to the attainment of the bank's stated objectives.

3. The board of directors should establish limitations applicable to futures, forward and standby contract positions and review periodically (at least monthly) contract positions to ascertain conformance with such limits.

4. The bank should maintain general ledger memorandum accounts or commitment registers to adequately identify and control all commitments to make or take delivery of securities. Such registers and supporting journals should at a minimum include:

(a) the type and amount of each contract,
(b) the maturity date of each contract,
(c) the current market price and cost of each contract, and
(d) the amount of money held in margin accounts.

5. All open positions should be reviewed and market values determined at least monthly (or more often, depending on volume and magnitude of positions), regardless of whether the bank is

required to deposit margin in connection with a given contract.4/ All futures contracts should be marked to market at least monthly. Any loss related to open forward and standby5/ contracts should be recognized on the basis of the lower of cost or market value of the underlying security as determined at month-end.6/ At the State member bank's option open forward contracts maintained in trading accounts may be carried at market.

6. Completed futures, forward or standby contracts giving rise to acquisition of securities will require such security transactions to be recorded on the basis of the lower of contract price or market price on settlement date. If the market value of the securities is lower than the contract price, the difference should be recorded as an immediate charge against income.

7. Fee income received by a bank in connection with a standby contract should be deferred at initiation of the contract and accounted for as follows:

a. upon expiration of an unexercised contract the deferred amount should be reported as income;

b. upon a negotiated settlement of the contract prior to maturity, the deferred amount should be accounted for as an adjustment to the expense of such settlement, and the net amount should be transferred to the income account; or

c. upon exercise of the contract, the deferred amount should be accounted for as

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4/ Underlying security commitments relating to open futures and forward contracts should not be reported on the balance sheet. Margin deposits and any unrealized losses (and in certain instances as noted below, unrealized gains) are usually the only entries to be recorded on the books. See "General Instructions" to the Reports of Condition and Income for additional details.

5/ Losses on standby contracts need be computed only in the case of the party committed to purchase under the contract, and only where the market value of the security is below the contract price adjusted for deferred fee income.

6/ Should margin on forward contracts be required, and assuming the margin accounts would work in the same manner as exchange margins, bank forward contracts should be carried at market to reflect the margin transactions.

an adjustment to the basis of the acquired securities. Such adjusted cost basis should be compared to market value of securities acquired. See item 6.

8. Bank financial reports should disclose in an explanatory note any futures, forward and standby contract activity that materially affects the bank's financial condition.

9. To insure that banks minimize credit risk associated with forward and standby contract activity, banks should implement a system for monitoring credit risk exposure associated with various customers and dealers with whom operating personnel are authorized to transact business.

10. Banks should establish other internal controls including periodic reports to management and internal audit programs to assure adherence to bank policy, and to prevent unauthorized trading and other abuses.

The issuance of long-term standby contracts, i.e., those for 150 days or more, which give the other party to the contract the option to deliver securities to the bank will ordinarily be viewed as an inappropriate practice. In almost all instances where standby contracts specified settlement in excess of 150 days, supervisory authorities have found that such contracts were related not to the investment or business needs of the institution, but primarily to the earning of fee income or to speculating on future interest rate movements. Accordingly, the Board concludes that State member banks should not issue standby contracts specifying delivery in excess of 150 days, unless special circumstances warrant.

The Board intends to monitor closely State member bank transactions in futures, forward and standby contracts to ensure that any such activity is conducted in accordance with safe and sound banking practices. In light of that continuing review, it may be found desirable to establish position limits applicable to State member banks. Supervisory action in individual cases under the Financial Institutions Supervisory Act (12 U.S.C. 1818 (b)) may also be instituted if necessary.

This policy statement will become effective January 1, 1980 and will apply to all outstanding contracts as well as those entered into by State member banks after January 1. The Board, however, will receive comments on this policy statement. Interested parties may submit comments and information on this statement in writing to Theodore E. Allison, Secretary of the Board of Governors of the Federal Reserve System, Washington, D. C. 20551, to be received by December 15, 1979. All material submitted should include the Docket Number R-0261.

Such material will be made available for inspection and copying upon request except as provided in section 261.6(a) of the Board's Rules Regarding Availability of Information (12 CFR 261.6(a)).

By order of the Board of Governors of the Federal Reserve System, November 15, 1979.

(Signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

[SEAL]

b. Release from the Federal Reserve Board for bank holding companies, dated August 21, 1980

FEDERAL RESERVE press release

For immediate release August 21, 1980

The Federal Reserve Board has approved the attached policy statement, in the form of a letter to bank holding companies, dealing with bank holding company participation in forward placement or delayed delivery contracts and interest rate futures contracts.

The Board, together with the other Federal bank supervisors, has previously issued precautionary rules and guidelines concerning commercial bank activities in these fields.

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LETTER TO BANK HOLDING COMPANIES

The three Federal bank regulatory agencies jointly issued revised policy statements on March 14, 1980 which set forth precautionary rules and specific guidelines for banks that may consider it desirable to enter into futures, forward and standby contracts on U. S. Government and agency securities ("financial contracts"). A copy of the press release announcing these revisions is enclosed for your convenient reference. In recent months, questions have arisen concerning the application of the joint bank policy statements to bank holding companies that might consider engaging in similar practices.

In supervising the activities of bank holding companies, the Board has adopted and continues to follow the principle that bank holding companies should serve as a source of strength for their subsidiary banks. Accordingly, the Board believes that any positions that bank holding companies or their nonbank subsidiaries take in financial contracts should reduce risk exposure, that is, not be speculative.

If the parent organization or nonbank subsidiary is taking or intends to take positions in financial contracts, that company's board of directors should approve prudent written policies and establish appropriate limitations to insure that financial contract activities are performed in a safe and sound manner with levels of activity reasonably related to the organization's business needs and capacity to fulfill obligations. In addition, internal controls and internal audit programs to monitor such activity should be established. The board of directors, a duly authorized committee thereof or the internal auditors should review periodically (or at least monthly) all financial contract positions to insure conformance with such policy and limits. In order to determine the company's exposure, all open positions should be reviewed and market values determined at least monthly, or more often, depending on volume and magnitude of positions.

In formulating its policies and procedures, the parent holding company may consider the interest rate exposure of its nonbank subsidiaries, but not that of its bank subsidiaries. As a matter of policy, the Board believes that any financial contracts executed to reduce the interest rate exposure of a bank affiliate of a holding company should be reflected on the books and records of the bank affiliate (to the extent required by the bank policy statements), rather than on the books and records of the parent company. If a bank has has an interest rate exposure that management believes requires hedging with financial contracts, the bank should be the direct beneficiary of any effort to reduce that exposure. The Board also believes that final responsibility for financial contract transactions for the account of each affiliated bank should reside with the management of that bank.

As you may know, the joint bank policy statements referred to above include accounting guidelines for banks that engage in financial contract activities. Since a special task force of the American Institute of Certified Public Accountants is presently considering accounting standards for contract activities, no specific accounting requirements for financial contracts entered into by parent bank holding companies and nonbank subsidiaries are being mandated at this time. The Board expects to review further developments in this area.

The Board intends to monitor closely bank holding company transactions in financial contracts to ensure that any such activity is consistent

with maintaining a safe and sound banking system. In any cases where bank holding companies are found to be engaging in speculative practices, the Board is prepared to institute appropriate action under the Financial Institutions Supervisory Act of 1966, as amended.

Enclosure

Joint News Release

Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board

For immediate release

March 14, 1980

The three Federal bank regulatory agencies today announced a number of revisions in their guidelines for banks that engage in futures, forward and standby contracts on U.S. government and agency securities.

The changes announced today were to guidelines adopted last November. The Federal Deposit Insurance Corporation and the Federal Reserve Board incorporated the guidelines in a policy statement. The Comptroller of the Currency's guidelines were contained in an operating circular.

In one change, adopted by the FDIC and the Federal Reserve, futures and forward contracts executed by State chartered banks before January 1, 1980 were exempted from the accounting procedures specified in the guidelines. The Comptroller of the Currency retained the January 1 effective date for all contracts entered into by national banks, as the Comptroller has had similar accounting provisions in effect since 1977.

Other principal changes in the guidelines adopted in the light of substantial comment received since the guidelines were published last November, include the following:

1. Banks may exercise the option of carrying futures and forward positions on a market or on a lower of cost or market basis.

2. Futures and forward contract activities associated with bona fide hedging of a mortgage banking operation are exempted from the otherwise prescribed accounting treatment for such contracts.

3. A number of other technical changes have been made, including relaxation of the requirement that a bank's board of directors review contracts at least monthly.

The agencies adopted the guidelines following a Treasury/Federal Reserve Study indicating that banks can effectively use financial futures contracts to hedge their risk of losses due to changes in interest rates, but noting that improper use of interest rate futures contracts increases, rather than decreases, the risk of loss due to changes in interest rates.

In addition to their guidelines, the agencies provided the following precautionary rules to banks they supervise:

1. Banks that engage in futures, forward or standby contract transactions should do so only in accordance with safe and sound banking practices.

2. Such transactions should be of a size reasonably related to the bank's business needs and to its capacity to fulfill obligations incurred.

3. The positions banks take in futures, forward and standby contracts should be such as to reduce the bank's exposure to loss through interest rate changes.

4. Policy objectives should be formulated in the light of the bank's entire mix of assets and liabilities.

5. Standby contracts calling for settlement in excess of 150 days should not be issued by banks except in special circumstances and ordinarily such long term standby contracts would be viewed by the agencies as being inappropriate.

The 10-point guidelines that should be followed by banks authorized to participate in these markets include directives on the role of bank boards of directors, record keeping, monitoring of such activities, valuation of contracts, treatment of fee income in connection with a standby contract, disclosures of activity by a bank in futures, forward and standby contracts, monitoring of credit risk exposure and internal controls at banks.

The text of the guidelines is attached.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 5, 1980

Mr. James A. Culver
Director of Economics
Commodity Futures Trading
Commission
2033 K Street, N.W.
Washington, D.C. 20581

Dear Mr. Culver:

This letter responds to the Commodity Futures Trading Commission (CFTC) request for Board comment on amended applications from the New York Futures Exchange (NYFE) to trade futures contracts calling for the delivery of 3-month Treasury bills and long-term Treasury bonds.

In commenting on this application, the Board is taking into account the pending merger of NYFE with the American Commodities Exchange (ACE). In addition, the Board understands that NYFE has sent a letter to the CFTC which indicates that, in the event the merger is completed, NYFE would phase out the 3-month Treasury bill contract and long-term Treasury bond contract now trading on ACE and substitute the two pending contracts.

If the CFTC is assured that the planned merger will be consummated and that NYFE will retire the existing ACE contracts before introducing its proposed contracts, the Board finds no reason to object to CFTC approval of the two applications. Under these conditions, the substitution of contracts that NYFE has indicated it intends would involve no additional proliferation of contract markets, a principal concern raised by the Board in its comments on NYFE's previous contract proposals.

The Board also notes that NYFE has lengthened the delivery period for its bond contract from one to three days and has specified a delivery month that will not overlap with delivery months for contracts trading on other exchanges. Thus, NYFE has modified its earlier bond contract proposal in ways that respond to the comments we made last fall.

NYFE has also made significant modifications to its proposed 3-month bill contract which make it more acceptable to the Board. In particular, NYFE has indicated that it will use the same delivery months for its 3-month bill contract as those currently designated for the ACE bill contract. Thus, there would be no direct overlap with the delivery months of 3-month bill contracts trading on the International Monetary Market and the Commodity Exchange of New York.

The deliverable supply for the proposed 3-month bill contract has also been broadened by NYFE to include, in addition to currently issued 3-month bills and 6-month bills issued 3 months earlier, a 1-year bill issued 9 months earlier. It is hoped that this broadening of issues eligible for delivery against the contract together with the recent increases in the volume of 3- and 6-month bills being issued will expand the deliverable supply sufficiently to minimize possibilities of distortions arising in the cash market for Treasury bills because of trading activity related to the futures market.

In this regard the Board would note that over the past year or so the Treasury bill yield curve appears to have been pulled out of alignment in the week to two week period preceding the delivery dates for the 3-month Treasury bill futures contracts traded on the International Monetary Market (IMM). That is, yields on bills deliverable against these contracts and on closely surrounding bills have been depressed by as much as 10 to 20 basis points relative to rates on bills with immediately shorter and longer maturities.

It seems a reasonable presumption that this development may be related to positioning by market participants in preparation for the heavy volume of actual deliveries made against these contracts relative to the size of the total deliverable supply. Whether or not relatively heavy deliveries account for all of the observed distortions, it would appear clearly desirable to broaden deliverable supplies against the existing Treasury bill futures contracts traded on the IMM, and on the Commodity Exchange (COMEX) as well. As a first step in this direction, the IMM and COMEX might specify delivery dates within their respective contract months so that--as in the case with the NYFE proposal--they correspond with the day that a previously issued 1-year bill becomes a bill due to mature in 3 months. More preferably, the Board would recommend--as it has in the past--that deliverable supplies against all bill futures contracts be expanded still further to include 3-month bills--and 6-month bills issued 3 months earlier --issued on other dates within a contract month.

Finally, the Board would restate a recommendation made initially in the Treasury-Federal Reserve study and repeated in subsequent correspondence--namely, that if essentially similar contracts are offered by more than one exchange, the exchanges should agree to rules for dealing with emergencies that are equally effective. Requiring this agreement will help to avoid a competitive devaluation of regulatory standards.

Sincerely yours,

Theodore E. Allison
Secretary of the Board

Actual Deliveries on Most Active Financial Futures (Number of Contracts)

Contract	T-Bills* (IMM)	T-Bonds** (CBOT)	GNMA's** (CBOT) CDR	New
Dec 75			32	
Mar 76	34		230	
Jun 76	159		52	
Sep 76	210		162	
Dec 76	362		183	
Mar 77	76		247	
Jun 77	127		773	
Sep 77	96		403	
Dec 77	172	729	33	
Mar 78	158	195	372	
Jun 78	363	1219	178	
Sep 78	293	1121	373	
Dec 78	442	3560	1448	
Mar 79	301	2250	477	44
Jun 79	706	2341	222	386
Sep 79	637	2442	2056	1409
Dec 79	1000	2332	516	989
Mar 80	503	4226	935	499

*Each contract is for a face value of $1 million.
**Each contract is for a face value of $100,000.

B. "NO SQUEEZING, NO CORNERING: SOME RULES FOR COMMODITY EXCHANGES," RALPH T. BYRD, HOFSTRA LAW REVIEW, VOL. 7, NO. 4, SUMMER, 1979, PP. 923–952

NO SQUEEZING, NO CORNERING: SOME RULES FOR COMMODITY EXCHANGES

The "temporary emergency rules"[1] promulgated under the Commodity Futures Trading Commission Act of 1974[2] authorize commodity exchanges to take various measures to prevent commodity futures market manipulation.[3] However, these rules may be ineffective if the commodity exchanges have discretion over their enforcement. For decades, commodity exchanges had the means to prevent various types of market manipulation,[4] but often ignored the problem or imposed penalties for completed conduct.[5]

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[1] 17 C.F.R. § 1.41(f) (1978) provides in part:

> In the event of an emergency, a contract market, by a two-thirds vote of its governing board, *may* place into immediate effect a temporary emergency rule to deal with the emergency without prior Commission approval . . .:
>
> . . . .
>
> (3) A temporary emergency rule *may* provide for, or *may* authorize the contract market . . . to undertake actions necessary or appropriate to meet the emergency, including, but not limited to, such actions as:
>
> (i) Limiting trading to liquidation only, in whole or in part, or limiting trading to liquidation only except for new sales by parties who have the commodity to deliver pursuant to such sales;
>
> (ii) Extending or shortening the expiration date for trading in contracts;
>
> (iii) Extending the time of delivery;
>
> (iv) Changing delivery points;
>
> (v) Ordering the liquidation of contracts, the fixing of a settlement price or the reduction in positions;
>
> (vi) Ordering the transfer of contracts, and the money, securities, and property securing such contracts, held on behalf of customers by a member of the contract market to another member, or other members, of the contract market willing to assume such contracts or obligated to do so;
>
> (vii) Extending, limiting or changing hours of trading;
>
> (viii) Suspending trading; and
>
> (ix) Modifying or suspending any provision of the rules of the contract market.

Id. (emphasis added).

[2] Pub. L. No. 93-463, 88 Stat. 1389 (codified at 7 U.S.C. §§ 2-22 (1976)).

[3] Before passage of the 1974 Act, federal regulations provided little control over essential exchange functions, such as dealing with emergency situations involving the threat of market manipulation. Note, *The Role of the Commodity Futures Trading Commission Under the Commodity Futures Trading Commission Act of 1974*, 73 MICH. L. REV. 710, 718 (1975).

[4] *See* notes 113-114 *infra* and accompanying text.

[5] *See* text accompanying notes 26-29 *infra*.

This Note examines those forms of market manipulation amenable to preventive regulation, focuses on the inequities of judicial resolution of manipulation, and proposes a course of action to protect commodity market operation from the inconsistent approaches previously taken by commodity exchanges.

FUNCTIONS OF THE EXCHANGE

A commodity exchange is a marketplace through which contracts are made for the future delivery[6] of a specified quantity and grade of a particular commodity. Each contract must be confirmed by a cash deposit called a "margin,"[7] after which a "clearinghouse" is substituted as buyer from the seller and as seller to the buyer.[8] Thereafter, each of the contracting parties is obligated only to the clearinghouse.

A commodity futures contract must either be satisfied by acceptance or delivery of the actual commodity during the delivery month,[9] or liquidated by entering into an exactly opposite and equal offsetting contract through the same broker, in the same future, prior to the specified delivery date.[10] Approximately ninety-nine percent of futures contracts are offset by opposite transactions before the delivery date.[11] Profits or losses are determined by the difference between each party's buy price and sell price minus the broker's commission.[12] A trader who fails to offset or deliver is in default on the contract.[13]

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[6] Delivery is usually permitted during any one of 12 successive calendar months. In some markets the outside limit may be 18 months in the future. J. BAER & O. SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 140-41 (1949). *See generally* T. HIERONYMUS, ECONOMICS OF FUTURES TRADING 40-41 (2d ed. 1977). The seller has the entire trading month that is specified in the contract to make delivery. J. BAER & O. SAXON, *supra*, at 141. However, the seller must give the buyer notice of impending delivery at least one business day in advance. 1 COMM. FUT. L. REP. (CCH) ¶ 6335 (1979).

[7] *See* 1 COMM. FUT. L. REP. (CCH) ¶ 315, at 1059 (1974).

[8] The volume of trading and duration of the contract make a direct contract between two individuals impractical. Exchanges have developed corporations to reconcile and assure the financial integrity of futures transactions. J. BAER & O. SAXON, *supra* note 6, at 164, 168, 182. *See generally* 1 COMM. FUT. L. REP. (CCH) ¶ 315 (1974); T. HIERONYMUS, *supra* note 6, at 45.

[9] When a futures contract is satisfied by delivery, delivery is effectuated by seller's tender and buyer's acceptance of a warehouse receipt covering a specified quantity and grade of a particular commodity stored in a designated warehouse approved by the exchange. The full cash contract price must then be paid. T. HIERONYMUS, *supra* note 6, at 37, 46.

[10] For example, a standard corn contract involves the purchase or sale of 5000 bushels of corn. If a trader had bought one contract of corn for May delivery ("May corn"), that trader would have to accept delivery of the warehouse receipts for 5000 bushels of corn before the end of May or liquidate by selling one contract of May corn (through the same broker who had executed the buy contract) prior to the end of May. Likewise if a trader had sold ten contracts of May corn (involving 50,000 bushels) that trader would have to deliver the warehouse receipts for 50,000 bushels of corn before the end of May or liquidate by buying ten contracts of May corn through the same broker who had executed the sell contract, before the end of May.

Commodity futures trading serves several economic functions.[14] Farmers use futures contracts to spread the sale of seasonal crops over many months, alleviating the uncertainty of supply and demand and resulting price fluctuations at the end of a harvest season.[15] In addition, a commodity producer or a dealer in the actual or "cash" commodity who has not yet made a cash sale may want protection from a decline in price before the sale is complete. This producer or dealer will "hedge"[16] actual inventory against any

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[11] *See* 5 FEDERAL TRADE COMMISSION, THE GRAIN TRADE 185 (1920) [hereinafter cited as FTC REPORT]; J. BAER & O. SAXON, *supra* note 6, at 138; T. HIERONYMUS, *supra* note 6, at 4; Campbell, *Trading In Futures Under The Commodity Exchange Act*, 26 GEO. WASH. L. REV. 215, 217 (1958).

[12] Broker fees vary with the exchange, among brokerage houses, and according to services provided. T. HIERONYMUS, *supra* note 6, at 354-57. *See generally* 1 COMM. FUT. L. REP. (CCH) ¶ 315, at 1060 (1974).

[13] Exchanges have varying regulations regarding default. Generally, if the buyer defaults, the seller has the right to sell the commodity in the open market and charge any losses to the buyer. If the seller defaults, the value of the commodity is determined by a board on the exchange and the seller is charged a penalty, usually 5 to 10% of the commodity's value as determined by the board. *See* T. HIERONYMUS, *supra* note 6, at 37. *See also* 5 FTC REPORT, *supra* note 11, at 187.

[14] *See* 7 FTC REPORT, *supra* note 11, at 207-20; J. BAER & O. SAXON, *supra* note 6, at 27-50; 1 COMM. FUT. L. REP. (CCH) ¶ 306 (1974); T. HIERONYMUS, *supra* note 6, at 173-97; Irwin, *The Nature of Risk Assumption in Trading on Organized Exchanges*, 27 AM. ECON. REV. 267 (1937); Working, *Futures Trading and Hedging*, 43 AM. ECON. REV. 314, 314-17 (1953); Note, *supra* note 3, at 711-15; Comment, *Federal Regulation of Commodity Futures Trading*, 60 YALE L.J. 822, 823-30 (1951).

[15] *See* Cargill, Inc. v. Hardin, 452 F.2d 1154, 1157-58 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972). *See generally* sources cited note 14 *supra*.

[16] *See* 7 FTC REPORT, *supra* note 11, at 207; J. BAER & O. SAXON, *supra* note 6, at 197-218; T. HIERONYMUS, *supra* note 6, at 175-200; MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., THE MERRILL LYNCH GUIDE TO HEDGING (1978) [hereinafter cited as MERRILL LYNCH GUIDE]; Working, *supra* note 14, at 314. *See also* 1 COMM. FUT. L. REP. (CCH) ¶ 306, at 1051 (1974). The uncertainties involved in the production and sale of commodities and the concomitant price fluctuations can produce both windfall profits and devastating losses. The hedger exchanges the possibility of windfall profits for the security of a fixed price. Hedging enables a commodity producer or dealer to calculate prospective profits without the danger of a price change by the time the actual commodity is delivered or received. The following illustrates how hedging protects a farmer:

> Suppose you are a corn producer in Iowa and you expect to have a crop that will yield 50,000 bushels of corn. In June, you check futures prices for September and see that corn for that month is quoted at $3.00 a bushel. This

> price would provide you with a fair profit if you could be sure of getting it when your crop is ready for delivery.
>
> Here's how you can make sure of getting that price:
>
> - Since each corn contract calls for 5,000 bushels, you sell 10 September futures contracts.
>
>   Now, no matter whether corn prices go up or down, you are assured of your fair profit when you sell your 50,000 bushels.
>
> - If prices should drop from $3.00 a bushel to $2.70, you would receive $15,000 less for your crop than you wanted.
>
>   But on your 10 futures contracts, you would make a profit of $1,500 per contract, or $15,000. So the net result would be the same as if corn prices had remained steady at $3.00 a bushel.
>
> The same is true if prices rise by 30¢ a bushel. You would receive $15,000 more for your crop but you would have a loss in the futures market of $15,000. So again, the net result is the same as if the $3.00 a bushel price had stayed steady.
>
> Hedging need not change your usual business procedures unless you want to change them. You would probably not deliver your crop to the Chicago futures market to meet your obligation. You would simply offset your futures contract by buying 10 September contracts and you would sell your production in the same way you normally sell it.
>
> On the other hand, if you were a corn dealer and you had forward commitments to sell at $3.00, you would do the opposite of what the producer did to obtain protection in the futures market. You would:
>
> - Buy 10 contracts of September corn at $3.00. If prices should rise to $3.30 a bushel at the time you complete your transaction, you would lose 30¢ a bushel in the cash market. But you would make a profit of 30¢ a bushel on your futures contracts so your position would be just where you wanted it to be.
> - If prices should drop to $2.70 at delivery time, you would make an extra 30¢ on your cash transaction, but this would be counterbalanced by a loss of 30¢ on your futures contracts.

MERRILL LYNCH GUIDE, *supra*, at 4-6. Likewise if you were a corn dealer who had forward commitments to *buy* at $3.00 you would want to protect yourself against a price decline just as you would if you were the corn producer protecting the sale price of his coming harvest.

The above examples are idealized; other factors affect hedging. For example, since futures contract sizes are standard, it may be difficult to trade quantities of futures that are identical to the quantities of the hedger's cash commodities. Rarely is a hedger perfectly hedged. The hedger is usually "underhedged," partially speculating in the cash commodity, or "overhedged," partially speculating in the futures market. *See generally id.* at 4; *see also* Working, *supra* note 14, at 314. And, of course, a producer or a dealer always incurs some risk when deciding on a price to protect. The price will afford one the expected profits only if there will be no unforeseen rise in costs unrelated to the price of the commodity. For example, a hedger might calculate that a price of three dollars per bushel for his corn will yield a profit of x percent based on certain costs of storage, labor, fuel, fire insurance, etc. Profits may dwindle, however, if these costs suddenly and unexpectedly increase. Nevertheless, because hedging protects against *major* loss, it is indisputably a worthwhile form of insurance for the producer or dealer. Recognizing this, bankers and lenders encourage, and occasionally require, hedging by individuals and companies that wish to use their commodity inventories as collateral for loans, often advancing a higher percentage of the value of the commodity if it has been hedged. *See* MERRILL LYNCH GUIDE, *supra*, at 7.

price decline by contracting to sell a quantity of commodity futures identical to the quantity of cash commodity intended for sale. Because futures prices generally parallel cash prices,[17] any decline in the price of the hedger's actual inventory by the time a purchaser is found is gained back by the profit on the futures exchange when the sell contract is offset with a buy contract.[18] Thus, trading in commodity futures can serve as insurance[19] for the dealer in cash commodities interested in protecting the price at which the actual commodity is bought and sold, rather than speculating in price changes for profit. Hedging reduces the effects of adverse price movements, enabling a producer or dealer to operate on a lower profit margin.

The speculator, on the other hand, is a trader willing to assume either a buy position ("long") or a sell position ("short") depending on whether prices are expected to rise or fall.[20] Speculators provide a ready market for the dealer in the cash commodity who wishes only to hedge.

Finally, the prices which result from the interplay between longs and shorts, speculators and hedgers are disseminated worldwide[21] and influence the price of a commodity on the cash market.[22]

THE PROBLEM: DEFINING MANIPULATION

For the futures market to perform its "insurance" function effectively, prices must reflect as nearly as possible the forces of supply and demand.[23] Price manipulation impedes the market's performance of its basic economic functions, diminishing the market's utility to those members of the trade and general public who rely on that performance.[24]

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[17] *See* 1 COMM. FUT. L. REP. (CCH) ¶ 305 (1974); T. HIERONYMUS, *supra* note 6, at 148-72.

[18] *See* note 16 *supra*.

[19] For a discussion of the difference between insurance and hedging, see T. HIERONYMUS, *supra* note 6, at 149-51.

[20] Most small speculators go long; large speculators go either long or short. Note, *Prevention of Commodity Futures Manipulation Under The Commodity Exchange Act*, 54 HARV. L. REV. 1373, 1377 (1941).

[21] At the end of 1975, Chicago Board of Trade quotations were received in 90 countries. T. HIERONYMUS, *supra* note 6, at 35.

[22] Although cash and futures markets are different, they are subject to the same influences. Commodity exchanges are economic barometers of worldwide weather conditions, political upheavals, labor unrest, consumer trends, and many other factors affecting the supply/demand tug of war for any given cash commodity. The price trends of both cash and futures markets therefore tend to move in the same direction. Absent manipulation, this is especially true as the futures-trading month draws near. As the expiration date approaches, prices are subject to progressively less uncertainty. Ultimately—in the absence of manipulation—as the future becomes the present, cash and futures prices in the expiring contract converge.

Because "[t]he methods and techniques of manipulation are limited only by the ingenuity of man,"[25] it is difficult to design regulations to anticipate and prevent every conceivable case of manipulation. Thus, sections 6b[26] and 9[27] of the Commodity Exchange Act,[28] as amended, proscribe deceptive and manipulative practices in general terms. Stiff penalties are imposed for violations.[29]

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[23] Cargill, Inc. v. Hardin, 452 F.2d 1154, 1158 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972). *See* Board of Trade v. Olsen, 262 U.S. 1, 39 (1923); J. BAER & O. SAXON, *supra* note 6, at 197-250.

[24] When the futures market is manipulated, the futures price is likely to be distorted from its normal relationship with the prevailing cash commodity price. The hedger faces an increased margin of risk if the hedger has to close out the hedge at a time when the futures market is experiencing this distortion. Any monetary loss from the resulting incomplete and inefficient hedging is passed on to the consuming public. *See generally* H.R. REP. NO. 975, 93d Cong., 2d Sess. 48 (1974). Further, fear of a manipulated market has a demoralizing effect on all traders, resulting in widespread avoidance of delivery-month trading. Trading liquidity is consequently lessened during the delivery month. This in turn contributes to the price distortion caused by a squeeze or corner because there will be fewer traders, other than those parties who are manipulating the price, through whom to liquidate. *See* notes 30-38 *infra* and accompanying text.

[25] Cargill, Inc. v. Hardin, 452 F.2d 1154, 1163 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972). *See also* David G. Henner Case, 30 Agric. Dec. 1151 (1971) (egg futures purchased at unnecessarily high price at close of trading day to deceive traders relying on price-movement chart formations into thinking that following day would be opportune time to buy). For criticism of chart-formation trading, see Irwin, *supra* note 14, at 271-77. *See also* Howard Randolph Case, 21 Agric. Dec. 219 (1962) (egg merchandiser deliberately caused floor broker on New York Mercantile Exchange to pay unnecessarily high purchase price for egg futures to produce higher price for merchandiser's sale of cash eggs, price of which was based on price of egg futures on day of delivery of cash eggs); Landon v. Butler Case, 14 Agric. Dec. 429 (1955) (cotton and grain merchandiser intentionally transmitted false information about lack of deliverable supply of soybeans). For discussion of the effect that local supply of certificated stock at the end of a delivery month can have on the price of that month's commodity futures, see text accompanying notes 30-38 *infra*. *See also* Ralph W. Moore Case, 9 Agric. Dec. 1299 (1950) (circulation of bogus "Memorandum to the Press," purportedly endorsed by Department of Agriculture, containing false and misleading information regarding government purchases of lard); Ruben Earl McGuigan Case, 5 Agric. Dec. 249 (1946) (defendant assumed market position, then advertised and represented himself to be in business of selling market advice to traders and sent out telegrams advising purchases and sales which would favorably affect his position). A relatively common form of manipulation occurs when a floor broker, allowed to trade for his or her own account as well as for other accounts, notices the beginning of a price fluctuation and trades accordingly for his or her own benefit. This dual trading by floor brokers adds momentum to otherwise minor price fluctuations, producing "mini-manipulations" throughout the trading day. For discussion of floor broker malfeasance, see *Commodity Futures Trading Commission Act of 1974: Hearings on S. 2485, S. 2578, S. 2837, H.R. 13113 Before the Senate Comm. on Agriculture and Forestry*, 93d Cong., 2d Sess. 207-24 (1974) (statement of Rep. Neal Smith) [hereinafter cited as *Senate Hearings*]; Note, *supra* note 3, at 730-39. For discussion of how loopholes in current law give foreign governments the potential to manipulate United States commodity futures prices, see *id.* at 747-48.

The only way to *dictate* a manipulated price is through the use of a squeeze or a corner. A squeeze develops when, toward the end of a delivery month, a dominant long[30] apparently wishes to take delivery on contracts rather than offset the price and the local supply of certificated stock[31] is insufficient to meet this delivery.

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[26] 7 U.S.C. § 9 (1976) (original version at ch. 369, § 6b, 42 Stat. 998 (1922)) (civil penalty for manipulation) which provides in part:

> If the [Commodity Futures Trading] Commission has reason to believe that any person . . . is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity . . . it may serve upon such person a complaint stating its charges in that respect . . . requiring such person to show cause why an order should not be made prohibiting it from trading on or subject to the rules of any contract market, and directing that all contract markets refuse all trading privileges to such person, until further notice of the Commission, and to show cause why the registration of such person, if registered as futures commission merchant or any person associated therewith . . . , commodity trading advisor, commodity pool operator, or as floor broker hereunder, should not be suspended or revoked. . . . Upon evidence received, the Commission may prohibit such person from trading on or subject to the rules of any contract market and require all contract markets to refuse such person all trading privileges thereon for such period as may be specified in the order, and, if such person is registered as futures commission merchant . . . , commodity trading advisor, commodity pool operator, or as floor broker hereunder, may suspend, for a period not to exceed six months, or revoke, the registration of such person, and may assess such person a civil penalty of not more than $100,000 for each such violation.

[27] *Id.* § 13 (1976) (original version at ch. 369, § 9, 42 Stat. 998 (1922)) (criminal penalty for manipulation) which provides in part:

> It shall be a felony punishable by a fine of not more than $100,000 or imprisonment for not more than five years, or both, together with the costs of prosecution, for any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any contract market . . . .

[28] *Id.* §§ 1-22 (1976) (originally enacted as Grain Futures Act, ch. 369, 42 Stat. 998 (1922) (retitled "Commodity Exchange Act" by Act of June 15, 1936, ch. 545, 49 Stat. 1491)).

[29] Violators may lose trading privileges and face fines, *id.* § 9 (1976), and/or jail sentences, *id.* § 13.

[30] A "dominant long" is a long who controls a sufficient number of contracts to enable him or her to dominate the market and exact an arbitrary price for his or her contracts. *See* Cargill, Inc. v. Hardin, 452 F.2d 1154, 1164 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972). Arguably the last long or short in the market in any expiring future is dominant; however, this argument was rejected in *Cargill*. *Id.*

[31] Before a commodity can be delivered it must be certificated as being of the proper grade. *See id.* at 1157; J. BAER & O. SAXON, *supra* note 6, at 86-95. *See generally* T. HIERONYMUS, *supra* note 6, at 33, 46.

The shorts, finding no other sellers from whom to buy the needed commodity to liquidate their positions, and unable or unwilling to acquire the certificated stock necessary for delivery on the contracts, can then avoid default only by outbidding each other in an effort to persuade the dominant long to sell the contracts back to them. The resulting, albeit temporary, high price for futures does not reflect true supply and demand, but merely a phenomenon peculiar to the particular delivery month. Natural squeezes may develop when the shortage in the delivery month occurs by chance and the long's commitments require that delivery be taken on the futures positions.[32] However, when knowledge of a shortage of deliverable supplies tempts a long into increasing the long position and apparently standing for delivery when the only purpose is to exact an exaggerated price from panicked shorts, the squeeze is considered manipulative and a cause for disciplinary action arises against the long.[33]

A corner in the futures market differs from a squeeze in that the "shortage" of deliverable stock results from a dominant long having secured ownership of that stock.[34] While there may be an abundance of actual deliverable stock, most of it is owned by the party with the dominant long interests in the futures market. This situation is analogous to a squeeze. However, instead of an actual shortage of deliverable stock, there is only a shortage of deliverable stock not controlled by the dominant long. Thus, the long is in a position to dictate both the price of liquidation for the shorts and the purchase price of the deliverable commodity.[35] Natural corners may develop when the owner of most of the stock acquired it for bona fide sales purposes and commitments require that delivery be taken on the futures contracts.[36] However, if after acquiring a dominant interest in the deliverable cash commodity, the owner increases the long position and stands for delivery to exact an artificial price from panicked shorts, the corner, like the squeeze,[37] is considered manipulative and a cause for disciplinary action arises against the long.[38]

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[32] Cargill, Inc. v. Hardin, 452 F.2d 1154, 1162 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); 7 FTC REPORT, *supra* note 11, at 243; J. BAER & O. SAXON, *supra* note 6, at 83.

[33] *See, e.g.*, Volkart Bros. Case, 20 Agric. Dec. 306 (1961), *vacated*, 311 F.2d 52 (5th Cir. 1962).

[34] *See* J. BAER & O. SAXON, *supra* note 6, at 83; T. HIERONYMUS, *supra* note 6, at 321-28. *See also* Cargill, Inc. v. Hardin, 452 F.2d 1154, 1162 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); 7 FTC REPORT, *supra* note 11, at 242-44.

[35] *See* note 30 *supra*. *See generally* Cargill, Inc. v. Hardin, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); Volkart Bros. v. Freeman, 311 F.2d 52 (5th Cir. 1962); G.H. Miller & Co. v. United States, 260 F.2d 286 (7th Cir. 1958), *cert. denied*, 359 U.S. 907 (1959); Great W. Food Distribs., Inc. v. Brannan, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); General Foods Corp. v. Brannan, 170 F.2d 220 (7th Cir. 1948); Peto v. Howell, 101 F.2d 353 (7th Cir. 1938). *See also How Jack Simplot, Other Big Traders Waged a Potato War*, Wall St. J., June 1, 1976, at 1, col. 1 (describing "Maine potato scandal").

Occasionally the shorts try to squeeze the longs by tendering large numbers of delivery notices early in the delivery month, hoping the longs will panic and liquidate rather than accept deliveries. Theoretically this pushes prices down, enabling the shorts to buy back at a lower price.[39] Conceivably, the mere possibility of this scheme is one cause of manipulative corners: Longs accumulate large holdings of deliverable supplies trying to defend their futures positions against such tactics by the shorts.[40] Nevertheless, when the longs successfully defend themselves and strike back at the shorts by standing for further deliveries, the longs may become subject to disciplinary action.[41]

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[36] *See* 7 FTC REPORT, *supra* note 11, at 243. *But see* J. BAER & O. SAXON, *supra* note 6, at 82.

[37] The terms "squeeze" and "corner" are sometimes confused. *See generally* Cargill, Inc. v. Hardin, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); Volkart Bros. v. Freeman, 311 F.2d 52 (5th Cir. 1962). This is because a pure squeeze, one in which there are no deliverable supplies whatsoever, virtually never occurs. Because there are usually some supplies when there is a squeeze, these supplies must be "cornered." Thus, in practice, a squeeze usually involves some small-scale "cornering." *See generally* 7 FTC REPORT, *supra* note 11, at 242-44; J. BAER & O. SAXON, *supra* note 6, at 83.

[38] *See generally* Cargill, Inc. v. Hardin, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); Volkart Bros. v. Freeman, 311 F.2d 52 (5th Cir. 1962); G.H. Miller & Co. v. United States, 260 F.2d 286 (7th Cir. 1958), *cert. denied*, 359 U.S. 907 (1959); Great W. Food Distribs., Inc. v. Brannan, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); General Foods Corp. v. Brannan, 170 F.2d 220 (7th Cir. 1948); Peto v. Howell, 101 F.2d 353 (7th Cir. 1938); *see also How Jack Simplot, Other Big Traders Waged a Potato War*, Wall St. J., June 1, 1976, at 1, col. 1 (describing "Maine potato scandal").

[39] *See* T. HIERONYMUS, *supra* note 6, at 325; Comment, *Manipulation of Commodity Futures Prices—The* Great Western *Case*, 21 U. CHI. L. REV. 94, 102 (1953). *See generally* Hohenberg Bros. Cotton Co. Case, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,146 (1976). The shorts are incapable of employing the equivalent of a long-side squeeze or corner. The effectiveness of a squeeze or corner turns on the long's ability to seize an advantage when there is an insufficient supply of goods available to sellers. For the seller to accomplish an analogous manipulation would require that he or she force a situation wherein there is an insufficient number of buyers for the oversupply of goods. This is impractical if not difficult or impossible to accomplish in any one delivery month, because if the price goes too low in relation to the other months there will generally be buyers ready to take advantage of the bargain. *See* 7 FTC REPORT, *supra* note 11, at 254.

[40] *See generally* T. HIERONYMUS, *supra* note 6, at 325-26.

[41] *Id. See generally* cases cited note 35 *supra*.

Given these market realities, cornering or squeezing can be properly characterized as manipulative only when (1) traders become aware that their trading behavior is likely to result in a corner or squeeze and they nevertheless persist in that behavior, and (2) the trading behavior is not consistent with any legitimate business purpose. Only then will traders have the requisite knowledge and intent to impute culpability for market manipulation. But such knowledge or intent can rarely be shown unless traders are definitively informed that a corner or squeeze will likely result from their trading behavior. Therefore defining manipulation in terms of cornering or squeezing can be counterproductive. This is illustrated by the inequitable and inconsistent results reached by the various courts that have dealt with corners or squeezes.[42]

Variations in Court and Administrative Decisions

Although cornering and squeezing[43] are prohibited by the Commodity Exchange Act,[44] they are never specifically defined.[45] Since definition has been left to judicial and administrative construction, it was inevitable that conflicting standards and tests for manipulation would emerge.[46] The lack of a coherent definition leaves an aggressive, large-scale trader guessing at what point financial self-interest violates the act.

General Foods Corp. v. Brannan[47] is the first appellate decision to construe the term "manipulate" in the Commodity Exchange Act. General Foods Corporation allegedly cornered the rye futures market from December 1942 through May 1944. General Foods took delivery of 7,230,000 bushels of rye in satisfaction of futures contracts and allegedly "caused a tight situation in the Chicago rye market, with a resulting inflated and manipulated price."[48] After the Business Conduct Committee of the Chicago Board of Trade warned General Foods that such holdings might tend to create a corner and that no further purchases were to be made by General Foods without permission of the committee,[49] associates of General Foods, also named as defendants in the case, bought large numbers of additional rye futures and took delivery on approximately 2,000,000 more bushels.[50]

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[42] *See* text accompanying notes 43-108 *infra*.

[43] While squeezing is not expressly prohibited by the Act, it is clearly implicated because, in practice, all squeezing involves some cornering. *See* note 37 *supra*.

[44] 7 U.S.C. § 9 (1976) (original version at ch. 369, § 66, 42 Stat. 998 (1922)) (civil penalty for manipulation); *id*. § 13 (1976) (original version at ch. 369, § 9, 42 Stat. 998 (1922)) (criminal penalty for manipulation). For text of statutes, see notes 26 & 27 *supra*.

[45] *See* Grain Futures Act, ch. 369, 42 Stat. 998 (1922) (retitled "Commodity Exchange Act" by Act of June 15, 1936, ch. 545, 49 Stat. 1491) (current version at 7 U.S.C. §§ 1-22 (1976)).

[46] *See generally* text accompanying notes 47-108 *infra*.

[47] 170 F.2d 220 (7th Cir. 1948).

[48] *Id*. at 222.

At the administrative hearing,[51] the judicial officer construed "manipulate" to mean causing prices "to go up or down by means directed to either such end or to prevent prices from going up or down by means directed to such end."[52] However, there was no testimony regarding the normal, unmanipulated price of rye.[53] Nevertheless, based on inferences drawn from defendants' trading activities and incriminating statements,[54] the judicial officer found that General Foods and its associates had manipulated the market in violation of sections 6b and 9 of the Commodity Exchange Act.[55] The Seventh Circuit Court of Appeals, however, refused to draw the same inferences and emphasized that the government never contended that the transactions by defendants had any effect upon the price other than to "stabilize" it at a particular level.[56] The court of appeals concluded that manipulation does not include the mere "stabilization" of a "natural" price but rather "the creation of an *artificial* price."[57] Thus, the order of the judicial officer was set aside,[58] not because of insufficient evidence, but rather because the court of appeals defined the crime differently.

Both opinions ignored the shorts' role in the market manipulation. If General Foods and its associates had reached their capacity to accept deliveries while still holding open positions in expiring futures, they would have been forced to liquidate their remaining long futures contracts by selling,[59] thereby contributing to a price decline. It is plausible that those shorts still in the market during the final days of the delivery month were holding their positions in anticipation of such an impending profitable price collapse that never occurred. The trading activities of the shorts contributed to the manipulation. Therefore, it is possible that the artificial price was as much a result of the shorts' market activity as the longs' activity.

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[49] *Id.*

[50] *Id.*

[51] General Foods Corp. Case, 6 Agric. Dec. 288 (1947), *vacated*, 170 F.2d 220 (7th Cir. 1948). Upon allegations of market manipulation an administrative hearing is held, the outcome of which may be reviewed in the federal court of appeals for the circuit in which the petitioner is doing business. *See* 7 U.S.C. § 9 (1976) (civil penalty for manipulation).

[52] 6 Agric. Dec. at 305.

[53] *Id.* at 297.

[54] *Id.* at 313-15.

[55] *Id.*

[56] 170 F.2d at 230.

[57] *Id.* at 231 (emphasis added).

[58] *Id.* at 231.

[59] Otherwise they would have defaulted on their contracts. *See* note 13 *supra*.

The failure of the Commodity Exchange Act to specifically define the elements of manipulation proved troublesome for the court in *General Foods*.[60] Official market surveillance by two representatives of the Commodity Exchange Administration who had vast experience with grain exchanges did not detect any irregularities or perceive any need for regulatory preventive measures.[61] Although the Seventh Circuit did not dismiss the charges on vagueness grounds,[62] the court nevertheless evidenced concern:

> Of course, [the failure of Commodity Exchange Administration representatives to invoke regulatory measures] does not impair the right of the government to proceed as it has, but at the same time, we think it casts some reflection upon a determination made long subsequent to the happening of the events relied upon, that respondents attempted to manipulate or corner the market when no such activity was discernible by the agencies' own experienced men, who viewed and understood the situation at close range and while respondents' activities were in progress.[63]

Although this concern was voiced obliquely and seemed peripheral to the court's final decision, it was undoubtedly one factor influencing the ultimate outcome.[64]

The issue of the shorts' involvement in the manipulation was also ignored in *Great Western Food Distributors, Inc. v. Brannan*,[65] the next major case to involve an alleged manipulative corner. Again, the issue of lack of notice about what conduct constitutes a violation was dismissed.[66] *Great Western* concerned an alleged corner in, and manipulation of, the December 1947 egg futures market. During November and December of 1947, Great Western and associates purchased large quantities of December egg futures. Simutaneously, they purchased large enough quantities of actual or "cash" eggs so that when it came time for Great Western to take delivery in satisfaction of its futures contracts, it allegedly controlled the entire supply of deliverable eggs in Chicago and surrounding areas.[67] At the administrative hearing, "manipulation" was found to include "the effecting of a price which would be different if the price influencing efforts were absent, that is, not only the raising or lowering of price by means directed to either such end but the prevention of prices from going up or down according to free supply and demand conditions."[68] Using this definition of manipulation, Great Western was found to have violated section 9 of the Commodity Exchange Act.[69]

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[60] *See* 170 F.2d at 224.

[61] *Id.*

[62] *See id.*

[63] *Id.*

[64] *See generally id.* at 231.

[65] 201 F.2d. 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953).

[66] *See generally id.* at 484.

On appeal, however, no specific definition of manipulation was articulated: The Seventh Circuit found intentional cornering coupled with higher than "normal" prices sufficient to uphold the decision below.[70] By comparing the statistical price patterns of January 1948 futures and fresh eggs with the price of the allegedly manipulated December 1947 egg futures, it was "proved" that prices were abnormally high in December.[71] In addition, the court found the price of futures abnormally high in relation to supply and demand.[72] The finding of manipulative intent was based upon statements by one of the defendants to the effect that the trading program was initiated for the purpose of obtaining higher prices for December futures.[73] The court thus narrowly construed the critical issue: whether and how Great Western actually caused the price changes.

As in *General Foods*, it was only because the defendant longs *won* the pricing tug of war that they were charged with market manipulation; the court paid no heed to the likelihood that there had been shorts in the market who held their positions too long in expectation of an eventual price collapse.[74] Furthermore, since it was never shown that the defendants ever controlled more than fifty-one percent of Chicago's deliverable supply,[75] many of the shorts who paid the inflated liquidation prices may have done so because they had neither the intention nor the financial capability of obtaining the deliverable eggs even at an acceptable price, and not because they could only get the eggs at Great Western's prohibitve prices. They therefore had to liquidate at any price or default on their contracts.

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[67] *Id.* at 478.

[68] Great W. Food Distribs., Inc. Case, 10 Agric. Dec. 783, 815 (1951), *appeal denied*, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953).

[69] 7 U.S.C. § 13(b) (1976) (original version at ch. 369, § 9, 42 Stat. 998 (1922)) (criminal penalty for manipulation).

[70] *See* 201 F.2d at 479, 483.

[71] *Id.* at 482. While such criteria is not completely inapposite, any "proof" of price abnormality based on comparisons between past and present price patterns is fundamentally unreliable. If "proper" prices could be predicted with certainty from past market behavior, schools of market statisticians would be able to trade without fear of mistake. *See generally* Irwin, *supra* note 14, at 270-77. Because there are so many factors affecting supply and demand at any given time, it is difficult to prove price abnormality based on comparisons between past and present prices, different futures prices, or futures and cash prices without examining minutely all the circumstances surrounding the various prices. *See generally* T. HIERONYMUS, *supra* note 6, at 148-72.

[72] 201 F.2d at 482.

[73] *Id.* at 484.

The court noted that petitioners protested the lack of notice of the specific charges filed against them by citing the Administrative Procedure Act requirement that:

> Except in cases of willfulness . . . no . . . suspension . . . of any license shall be lawful unless, prior to the institution of agency proceedings therefor, facts or conduct which may warrant such action shall have been called to the attention of the licensee by the agency in writing and the licensee shall have been accorded opportunity to demonstrate or achieve compliance with all lawful requirements.[76]

The court dismissed this defense holding that the petitioners' acts were "willful" because they intentionally set out to raise prices.[77] But this response begs the question. The intent, purpose, and expectation of all speculators is to make a profit. Consequently, they cannot reasonably be expected to curtail their own trading behavior in the absence of clear guidelines if such a curtailment limits or jeopardizes their profits.[78] Thus, assuming arguendo that Great Western and associates traded in a manner that they hoped would raise prices and did in fact do so, it does not necessarily follow that they willfully set out to manipulate the market.[79] Given the ambiguity of the term "manipulation," only if the longs had been warned that their trading conduct was becoming manipulative and they persisted nevertheless could it be contended that they willfully manipulated the market.

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[74] *See* text accompanying note 59 *supra*. *See generally* Hieronymus, *Manipulation in Commodity Futures Trading: Toward a Definition*, 6 HOFSTRA L. REV. 41, 50-55 (1977).

[75] 201 F.2d at 481.

[76] *Id.* at 484 (citing 5 U.S.C. § 1008 (1952) (current version at 5 U.S.C. § 558 (1976))).

[77] *Id.*

[78] A long's purpose in accepting delivery instead of liquidating may not be to control the deliverable supply, but to refrain from exerting downward pressure on the futures' price. *See generally* text accompanying note 59 *supra*.

[79] There is no evidence that Great Western knew, or had reason to know, that its conduct was "manipulative."

The Fifth Circuit's decision in *Volkart Brothers v. Freeman*,[80] decided nine years after *Great Western*, reflects an uneasiness about imposing sanctions for violating an undefined prohibition against manipulation and the role of the shorts in producing market distortion.[81] *Volkart* involved alleged squeezing of the October 1957 cotton futures market by Volkart Brothers, a large cotton-merchandising corporation. On the last day of trading in October cotton futures, Volkart held 104 long contracts[82] representing eighty-nine percent of the total open interest[83] in cotton futures on the New York Cotton Exchange. Volkart allegedly exacted an arbitrary and manipulated liquidation price from the shorts by taking advantage of an insufficient local supply of certificated cotton available for delivery. At both the administrative hearing[84] and on appeal, "manipulation" was defined as " 'any and every operation or transaction or practice . . . calculated to produce a price distortion of any kind in any market either in itself or in relation to other markets. . . . Any . . . operation, transaction [or] device employed to produce these abnormalities of price relationship in the futures markets is manipulation.' "[85] On review, however, the Fifth Circuit decided that to constitute manipulation, Volkart would have had to intend to create the shortage of deliverable stock and to exploit the shortage for its own profit.[86] The court defined "manipulate" to include conduct *calculated* to produce a price distortion and not merely the charging of "unreasonably high" prices.[87] Otherwise, the statute prohibiting "manipulation" would be arguably unconstitutional as failing " 'to inform persons accused of violation thereof of the nature and cause of the accusation against them.' "[88] Because Volkart did not create the shortage of certificated cotton, but only exploited it, the court set aside the judicial officer's order.[89]

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[80] 311 F.2d 52 (5th Cir. 1962).

[81] *See generally* text accompanying notes 86-90 *infra*.

[82] Volkart Bros. Case, 20 Agric. Dec. 306, 307 (1961), *vacated*, 311 F.2d 52 (5th Cir. 1962).

[83] "Open interest" refers to the number of unsettled contracts. T. HIERONYMUS, *supra* note 6, at 42.

[84] Volkart Bros. Case, 20 Agric. Dec. 306, 339 (1961), *vacated*, 311 F.2d 52 (5th Cir. 1962).

[85] 311 F.2d at 58 (quoting *Hearings Before Subcomm. of Senate Comm. on Agriculture and Forestry*, 70th Cong., 1st Sess. 201-02 (1927) (testimony of Arthur R. Marsh, former President, New York Cotton Exchange)).

[86] *Id*. at 59.

[87] *Id*. at 58.

Furthermore, the court believed that the shorts' own lack of due diligence in preparing for delivery contributed to their untenable position in the futures market. The court noted that while there had been a shortage of *certificated* cotton, large supplies of *uncertificated* cotton had been stored in the port warehouses specified as delivery points for certificated cotton.[90] Because the shorts could have obtained this cotton and certificated it in time for delivery, the court refused to disregard the availability of these supplies in measuring the extent to which Volkart controlled the market.

Nine years later, in *Cargill, Inc. v. Hardin*,[91] the Eighth Circuit failed to achieve the breadth of analysis displayed in *Volkart*. Cargill, Inc. is one of the largest grain merchandisers and exporters in the country. By selling huge quantities of wheat abroad, Cargill radically depleted the supply of wheat in the Chicago area available for delivery on May 1963 wheat futures, while taking a long position of 1,990,000 bushels.[92] Cargill then waited until the last fifteen minutes of trading to begin liquidating its long position.[93] The resulting stampede by the shorts created an allegedly artificial price. At the administrative hearing, the judicial officer adopted the definition of manipulation used in the *General Foods* administrative hearing[94] and found Cargill guilty of market manipulation. On appeal the Eighth Circuit Court of Appeals adopted the definition of manipulation found in the *General Foods* appeal,[95] modifying it to include artifical price stabilization.[96] The court determined that prices were artificially high by comparing May 1963 wheat price futures with the prices of May wheat futures for the preceding nine years on the Chicago Board of Trade, and by comparing the price of May 1963 wheat futures with the price of cash wheat in May 1963—both patently unreliable methods of determining whether the price had been artifically set.[97] The finding that Cargill *caused* the "artificially high" price was based on the high liquidation prices Cargill was able to obtain from the shorts.[98] Thus, the court failed to acknowledge the dual origin of any given commodity futures price—the buyer's bid as well as the seller's offer—and therefore placed on Cargill undue responsibility for the unnatural rise in prices.[99] Cargill argued that the Administrative Procedure Act requires notice[100] that Cargill's conduct violated the Commodity Exchange Act.[101] However, the court dismissed this defense as was done in *Great Western*,[102] stating that no notice is required when the conduct in question is "willful."[103] The court examined the willfulness of the cornering by noting that Cargill not only exploited the lack of deliverable supplies,[104] but also created the shortage in May wheat by selling huge quantities of wheat abroad, albeit for bona fide sales purposes.[105] Cargill argued that the holding in *Volkart* is applicable, since Cargill's creation of the shortage was the inadvertent result of bona fide sales and therefore without manipulative intent.[106] The Eighth Circuit criticized *Volkart* and refused to consider Cargill's good faith defense.[107] Rather, the court held that mere exploitation of such a shortage violates the Act, rationalizing that a contrary holding would encourage excessive speculation in deliverable supplies toward the end of delivery months.[108]

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[88] *Id.* at 58 n.9 (quoting United States v. L. Cohen Grocery Co., 255 U.S. 81, 89 (1921)).

[89] *Id.* at 60. For criticism of this reasoning, see Comment, *The Delivery Requirement: An Illusory Bar to Regulation of Manipulation in Commodity Exchanges*, 73 YALE L.J. 171 (1963).

[90] 311 F.2d at 59.

[91] 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972).

[92] *Id.* at 1160.

[93] *Id.*

[94] *See* text accompanying notes 51 & 52 *supra*.

[95] *See* text accompanying note 57 *supra*.

[96] 452 F.2d at 1163.

The foregoing discussion demonstrates that while sections 6b and 9 of the Commodity Exchange Act prohibit manipulation, traders are without guidance as to what constitutes illegal conduct. Because manipulative trading may closely resemble normal, legitimate trading, transgressions of legal bounds by "manipulators" are often unintentional. Courts may examine the consequences of trading behavior—usually "abnormally" high prices accompanied by complaints from unhappy shorts—and assign blame to the traders who ostensibly "manipulated" the market—usually the longs. Although courts often fail to recognize that commodity futures market manipulation involves a battle of excessive speculation by both longs and shorts, it is the financial harm suffered by the losing speculators that gives rise to complaints against the winners. Consequently, when the cases are adjudicated, courts focus only on the culpable conduct of the winning speculators—only the winners are defendants. This approach ignores market realities and produces inequitable results.

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[97] *See* note 71 *supra*.

[98] 452 F.2d at 1169.

[99] For criticism of the practice of blaming only the longs for the manipulation, see T. HIERONYMUS, *supra* note 6, at 326-27; Hieronymus, *supra* note 74, at 54.

[100] *See* 5 U.S.C. § 558(c)(1) (1976).

[101] 452 F.2d at 1173.

[102] *See* text accompanying notes 77-79 *supra*.

[103] 452 F.2d at 1173.

[104] *Id.* at 1159-60. *See also* Volkart Bros. v. Freeman, 311 F.2d 52 (5th Cir. 1962).

[105] 452 F.2d at 1159-60.

[106] *Id.* at 1172.

[107] *See id.*

[108] *See id.* at 1173.

Past Attempts to Prevent Manipulation

Fortunately, the methods of controlling squeezes and corners are not limited to retrospective resolution. Because the factors contributing to a squeeze or a corner fall into a general pattern, these forms of manipulation can be anticipated and controlled by preventive regulation.[109] Thus Commodity Futures Trading Com-

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[109] For example, there are limits on the size of any trader's speculative holdings in the futures market. *See* 7 U.S.C. § 6(a) (1976); 17 C.F.R. §§ 150.1-.12 (1978). The purpose of these limits is to prevent price movements caused by the sheer volume of a trader's holdings. *See* T. HIERONYMUS, *supra* note 6, at 333-39. Such limits are "a first line of defense against individual traders dominating the market or engaging in activities that may cause price distortions, manipulations, corners, or squeezes." Memorandum of Points and Authorities in Support of Plaintiff's Motion for A Temporary Restraining Order and Preliminary Injunction at 3, CFTC v. Hunt, No. 77-C-1489 (N.D. Ill. Sept. 28, 1977), *aff'd*, 2 COMM. FUT. L. REP. (CCH) ¶ 20,726 (7th Cir. 1979). In *Hunt* the validity of speculative position limits was challenged by the defendants, who while not exceeding the speculative position limits individually, were far in excess of the position limits collectively. The validity of the speculative position limits was upheld, and the United States Court of Appeals for the Seventh Circuit ultimately upheld Hunt's conviction for violating government speculative position limits on soybean trading. *See* CFTC v. Hunt, 2 COMM. FUT. L. REP. (CCH) ¶ 20,726 (7th Cir. 1979).

Until recently, daily speculative trading limits specifying the maximum amount that a person could buy or sell during a single day in a single market applied to commodities traded on most domestic exchanges. 44 Fed. Reg. 7124 (1979); *CFTC Votes To Remove Daily Speculative Trading Limits*, J. Commerce, Dec. 20, 1978, at 7, col. 5. In late 1978 the CFTC voted to remove all daily speculative trading limits. The removal of daily speculative trading limits will now allow speculators to conduct transactions of any volume so long as the existing speculative *position* limits are not exceeded at any given moment. The CFTC based removal of daily speculative trading limits on the increase in market liquidity that would result and the minimizing effect that increased in-and-out trading would have on the price impact of large or-mission (CFTC) regulation 1.41(f) provides in part:

> (f) *Temporary emergency rules*. In the event of an emergency, a contract market by a two-thirds vote of its governing board, *may* place into immediate effect a temporary emergency rule to deal with the emergency without prior Commission approval . . . :
>
> . . . .
>
> (3) A temporary emergency rule *may* provide for, or *may* authorize the contract market . . . to undertake actions necessary or appropriate to meet the emergency . . . .[110]

Examples of such action include extending the delivery period to provide shorts with additional time to obtain the commodity from a more remote location, and changing delivery points to neutralize any local transportation problems hampering access to deliverable supplies.[111] If, in spite of such measures, the deliverable supply cannot be sufficiently increased, more radical action may be taken. For example, trading might be confined to the mandatory liquidation of contracts and new sales restricted to parties who have the actual commodity to deliver pursuant to such sales.[112]

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ders. *See* 44 Fed. Reg. 7124 (1979); *CFTC Votes To Remove Daily Speculative Trading Limits*, J. Commerce, Dec. 20, 1978, at 7, col. 5. Another method of alleviating potential manipulative pressures is a track delivery rule, a typical example of which is employed by the Board of Trade of Kansas City, Missouri:

> [The track delivery rule] permits deliveries of wheat in railroad cars in the Kansas City market during the last thirty days of a delivery month. This means, for example, that again were a tight situation to develop, persons on the other side of the market could, within the thirty days, fairly easily arrange to have wheat brought in on track in an effort to modify any developing problems.

Letter from W.N. Vernon, III, Executive Vice President and Secretary of the Board of Trade of Kansas City, Missouri, to the Author (Jan. 19, 1977) (on file in office of the *Hofstra Law Review*).

[110] 17 C.F.R. § 1.41(f) (1978) (emphasis added).

[111] *Id. See* COMM. FUT. L. REP. (CCH) ¶ 2177 (1976).

[112] COMM. FUT. L. REP. (CCH) ¶ 2177 (1976). A typical mandatory liquidation was effected as follows:

> Any person who, at the close of business on November 23, 1977, directly or indirectly owns or controls any December 1977 Coffee "C" contracts (long or short) through any clearing member shall reduce the number of such contracts (either by effecting liquidation trades or by making or accepting delivery of coffee) as follows: to 75% of the number so owned or controlled on November 23, 1977 by the close of trading on December 2, 1977; to 50% of the number so owned or controlled on November 23, 1977 by the close of trading on December 9, 1977; to 25% of the number so owned or controlled on November 23, 1977 by the close of trading on December 16, 1977; and to 10% of the number so owned or controlled on November 23, 1977 by the close of trading on December 20, 1977. In any case

Commodity exchanges have long been aware of the utility of emergency action[113] and most exchange bylaws authorize such actions.[114] That this discretionary action has not always been taken is due less to the subtle effects of manipulations[115] than to two other factors. First, exchange members lack self-discipline.[116] They are

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> where the application of any of the aforesaid percentages to the number of contracts so owned or controlled on November 23, 1977 results in a number other than a whole number, the reduction required under the preceding sentence shall be the next smaller whole number of contracts.

Resolution Relating to December 1977 Coffee "C" Contract Adopted by the Board of Managers of the New York Coffee and Sugar Exchange, Inc. 2-3 (Nov. 23, 1977) (Press Releases 77-7).

[113] *See* 7 FTC REPORT, *supra* note 11, at 252-53. "In the opinion of one prominent grain trade man, who is a member of the Chicago Board of Trade, the anti-corner rule now (since its amendment in 1921) 'absolutely prohibits any possibility of a squeeze,' absolutely stops 'what is commonly known as a corner,' and 'will absolutely work.' " *Id.* at 253. A forerunner of this general procedure was adopted by the Chicago Board of Trade as early as 1869. 5 FTC REPORT, *supra* note 11, at 178-79.

[114] *See, e.g.*, COFFEE, SUGAR & COCOA EXCHANGE, INC., Bylaw § 602 (1979); COMMODITY EXCHANGE, INC., Bylaw § 408 (1975); N.Y. COTTON EXCHANGE, Bylaw § 1.38 (1977).

[115] For an early legal opinion discussing the notoriety of some corners, see 5 FTC REPORT, *supra* note 11, at 325 (quoting statement from *Ex parte* Young, 6 Biss. (Bissel's U.S.C.C. Rep.) 58 (1874) (discussing general participation in corner by members of exchange)). Although some corners may be effectuated in clandestine manner through the use of several different brokers to obtain a dominant market position, *see* Peto v. Howell, 101 F.2d 353 (7th Cir. 1938), it would be impossible for clearinghouses not to notice a greater-than-normal open interest as the delivery month expires and, therefore, have reason for alarm. *See generally* J. BAER & O. SAXON, *supra* note 6, at 164-87; T. HIERONYMUS, *supra* note 6, at 43-47. In any case, the difficulties in determining market domination are not substantially different from the difficulties in determining violations of position limits. For other indications of the general notoriety of squeezes and corners, see G.H. Miller Case, 15 Agric. Dec. 1015, 1027-31 (1956) (reference to market letters from various brokerage houses speaking of "concentrated buying," "the development of a squeeze," and "congestion of the delivery month contributing to the price rise"). In General Foods Corp. Case, 6 Agric. Dec. 288 (1947), the Business Conduct Committee of the Chicago Board of Trade called one of the respondents before the committee and "informed" him that the "combined position" of General Foods and others "might tend to create a corner and be in a position to dominate price movements." *Id.* at 299. And the court in Fox Delux Case, 18 Agric. Dec. 582 (1959), mentions a market letter from a brokerage house speaking of "a large merchandisng interest which has been *conspicuous* on the long side of December eggs." *Id.* at 597 (emphasis added). In Volkart Bros. Case, 20 Agric. Dec. 306 (1961), *vacated*, 311 F.2d 52 (5th Cir. 1962), the court indicates "that professional traders recognized the *obvious* fact that a concentrated long would make or determine prices . . . on that day." *Id.* at 332 (emphasis added). The exchanges constantly receive information with regard to the availability of deliverable supplies and the identity of parties asking for or making delivery, and they are in a position to know of the development of a squeeze or corner. *See* 17 C.F.R. § 1.51 (1978).

[116] In all the cases involving corners listed in note 35 *supra*, exchange mem-

more likely to be either conducting the manipulation[117] or seeking to profit from the developing crisis than to be taking the necessary steps to rectify the market situation before it becomes critical. Thus when squeezes and corners occur, exchange members may be found on both sides of the market late into the delivery period, exacerbating the crisis rather than alleviating it.[118] Second, there is a need for objective standards for identifying potentially disruptive situations.[119] Some traders are likely to challenge the objectivity of

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bers were the defendants. *See* note 142 *infra*. *See also* 2 COMM. FUT. L. REP. (CCH) Report Letter 80, at 4 (Aug. 28, 1978), which states in part:

> After an investigation of the New York Mercantile Exchange's rule enforcement program, the CFTC Division of Trading and Markets has concluded that the exchange has the rudiments of a strong program in both market surveillance and trade practice surveillance, but that exchange members must become more involved into [*sic*] the analytical phases of compliance work.
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> . . . [T]he Division commented that the extent and quality of member participation in compliance matters was limited and that members did not appear totally committed to discharging their disciplinary functions. . . .
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> . . . .
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> Investigations of trading practice . . . were cited as being deficient in effective questioning of the brokers involved. . . .
>
> . . . Criticized by the Division was the disciplinary procedure of the exchange. Calling the procedure "neither prompt nor effective" the Division required that a report be submitted . . . explaining the steps that will be taken to accelerate the final resolution of complaints . . . .

Id. *See also id.* Report Letter 86, at 3 (Nov. 20, 1978), which provides in part:

> The CFTC Division of Trading and Markets has criticized the rule enforcement program of the New York Cotton Exchange following a review of that program. . . . [T]he Division called the Exchange's program disorganized, cursory, reactive, and reflecting little, if any, improvement from a similar review conducted in 1976.
>
> Warning that enforcement action may be recommended, the Division asked that improvement be forthcoming in the next several months in the areas of market surveillance, trade practice surveillance, the handling of customer complaints, and compliance program record keeping. Along with these problems, the Division noted particular interest in the Exchange developing an affirmative approach toward self-regulation.

Id.

[117] *See generally* Fox Deluxe Case, 18 Agric. Dec. 582, 612-13 (1956) ("Until the last few trading days, a substantial portion of these clearing members had positions on both sides of the market, although the concentration of long trading through respondent Fox Deluxe was by this time quite apparent."). Such tactics by brokers were suspected in CFTC v. Hunt, 2 COMM. FUT. L. REP. (CCH) ¶ 20,726 (7th Cir. 1979). *See* Maidenberg, *Questions in the Hunt Soybean Saga*, N.Y. Times, May 2, 1977, at 54, col. 1. *See generally* cases cited note 35 *supra*. *See also U.S. to Review Role of Chicago Board Official*, N.Y. Times, Mar. 23, 1979, at D1, col. 3.

[118] *See* note 117 *supra*.

[119] *See* 43 Fed. Reg. 15,438 (1978), *reprinted in* 2 COMM. FUT. L. REP

an exchange's ad hoc determination that trading prices have become, or are about to become, "artificial."[120]

PROPOSED SOLUTION

Because of the failings of discretionary ad hoc emergency action, the CFTC would do well to employ a consistent, predictable, and objective method for identifying and alleviating emergency situations.

As a contract expires, so long as the deliverable supply of a given commodity is neither depleted nor cornered, any inordinate rise in futures prices will always induce price-correcting short

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(CCH) ¶ 20,578 (1978) (describing proposed rule 1.52, better known as "The Twenty-five Percent Rule"). Essentially, proposed rule 1.52 would limit the size of trading positions during the last 15 days of the delivery month to less than 25% of the open interest, unless the exchange makes a determination that the holding is "not likely to result" in disorderly trading. The purpose of the rule was to prevent trading congestions during the delivery month "by placing an affirmative obligation on the contract market to analyze major positions and to take action if such positions could adversely affect trading." Division of Economics & Education, Commodities Future Trading Commission, Summary and Recommendations on Proposed Rule 1.52 (The "Twenty-five Percent Rule") 1 (1978) [hereinafter cited as Summary and Recommendations]. On April 13, 1978, the Commission solicited comment on the rule, to be received by July 12, 1978. 43 Fed. Reg. 15,438 (1978). The Commission received thirty-six comments on the proposed rule, including comments from exchanges, commercial users of futures markets, and private parties. Thirty-five of the responses to the proposed rule were unfavorable. The Commission decided to abandon the rule, largely because the "not likely to result in price manipulation or market congestion" standard could result in unneeded market intervention by an exchange that feared that failure to intervene might lead to ex post facto CFTC enforcement action against the exchange. Among other reasons for Commission abandonment of the proposed rule was recognition that a more important factor than position concentration affects the potential for market disruption, namely the magnitude of deliverable supplies. Consequently, a trading position of less than 25% of the open interest could be disruptive if the deliverable supply is insufficient, and a trading position of more than 25% of the open interest might not be disruptive if there is sufficient deliverable supply. *See* Summary and Recommendations, *supra*, at 5-9.

[120] *See generally* Summary and Recommendations, *supra* note 119, at 12. Such challenges are not likely to be successful: Courts apply a standard of liability for exchange market intervention highly favorable to the exchange. In Compania Salvadorena de Cafe, S.A. v. CFTC, 446 F. Supp. 687 (S.D.N.Y. 1978), the court described the exchange's power to take emergency actions to prevent market disorders as "without limit except that the Board must act in good faith." *Id.* at 691 (citations omitted). Likewise, in Lagorio v. Board of Trade, 529 F.2d 1290 (7th Cir. 1976), the court stated: "[W]e cannot believe that Congress intended . . . to impose liability for the good faith performance of regulatory duties . . . ." *Id.* at 1292. Nevertheless, an exchange's successful defense against such a suit can be expensive. *See* Letter from Bennett J. Corn, President, New York Coffee and Sugar Exchange, Inc., to Jane K. Stuckey, Executive Secretariat, CFTC, at 4 n.3 (July 12, 1978) (comments on proposed regulation 1.52) (on file in office of the *Hofstra Law Review*).

sales from traders capable of profiting by delivering the actual commodity instead of paying the inflated liquidation price on the futures market.[121] However, once the deliverable supply of a commodity is depleted or cornered, traders are incapable of delivering the actual commodity and further short sales only aggravate the ensuing liquidation by already panicked shorts.[122] Thus, it is the presence of a sufficient uncornered deliverable supply of a commodity that provides the market's inherent price-correcting mechanism. Without this mechanism, futures prices are subject to the control of the dominant long and the market is void of integrity. Therefore, while an exchange should be allowed to choose any reasonable method of averting an emergency situation before it develops,[123] once an exchange ascertains that the deliverable supply[124] of a given commodity is so dangerously low in proportion to the amount of open interest that there is no realistic delivery alternative to liquidation,[125] mandatory emergency measures should be

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[121] *See* Volkart Bros. Case, 20 Agric. Dec. 306, 338 (1961), *vacated*, 311 F.2d 52 (5th Cir. 1962); Comment, *supra* note 89, at 174.

[122] *See* text accompanying notes 30-38 *supra*.

[123] *See generally* 17 C.F.R. § 1.41(f)(3) (1978).

[124] For these purposes "deliverable supply" includes all supplies reasonably capable of delivery within the prescribed grace period, *see* 1 Comm. Fut. L. Rep. (CCH) ¶ 6315 (1976), and would exclude supplies controlled by long interests, since those supplies are unlikely to be used to hammer down any upward price movement. Obviously computation of "deliverable supply" will be little more than an informed estimate in some cases, depending upon the relative ubiquity of the commodity involved. For example, it would be much easier to trace the availability of deliverable supplies of "Maine potatoes" or "Kansas City wheat" (both of which have concentrated growing areas and delivery points) than deliverable supplies of "world sugar" with delivery points in the country of origin and growing areas in Argentina, Australia, Brazil, British Honduras, Colombia, Costa Rica, Dominican Republic, El Salvador, Ecuador, Fiji Islands, French Antilles, Guatemala, Haiti, Honduras, India, Jamaica, Mauritius, Mexico, Nicaragua, Peru, Republic of Congo (Brazzaville), Republic of the Philippines, Reunion, South Africa, Swaziland, Taiwan, Thailand, Trinidad, Venezuela, and the United States. *See* New York Coffee and Sugar Exchange, Inc., Trading in Sugar Futures 11 (1977). Fortunately, however, the more ubiquitous the commodity and the more delivery locations, the less susceptible the commodity is to manipulation. *See generally* Hieronymus, *supra* note 74, at 47-50.

[125] The following is a typical example of how such a determination is made and acted upon:

> In mid-November, concerns over the diminishing supply of tenderable coffee available for delivery appeared valid as prices for the expiring December 1977 "C" coffee contract began to widen from those of the March [1978] contract. Much of the coffee delivered on the July and September contracts was still held either by those interests which [accepted] the deliveries, or sold to interests with declared domestic and export commitments. It

triggered automatically. Normal trading should cease, and liquidations should be compulsory. New sales should be restricted only to

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> appeared probable that this coffee, although certificated, was an unlikely source for fulfilling the large open interest persisting midway through November. *The estimated availabe [sic] deliverable stocks were only a small fraction of that required to satisfy the large open interest.*
>
> The Commodity Futures Trading Commission and officials of the New York Coffee and Sugar Exchange agreed that an extremely tight situation existed.
>
> Day-by-day surveillance of the market indicated a developing problem. . . . On November 21, the Commission met with Exchange representatives to discuss a course of action. An executive session of the Commission and staff was held on November 22 for further discussion of the December contract. . . . .
>
> Most coffee interests had predicted the problem would not be alleviated by new crop arrivals in New York until late December or early January. . . . Moreover, rumors persisted that a number of coffee shipments moving into New York either did not meet grade requirements or were only marginally within minimum deliverable quality standards for delivery on the "C" contract.
>
> Commission and Exchange officials concluded that an emergency did, in fact, exist. On November 23, the Exchange declared the emergency and ordered trading for liquidation only. The Commission supported the Exchange action and also issued a formal declaration of an emergency and ordered a scheduled liquidation of the open interest.
>
> The Commission said that on the basis of market surveillance data and information reported to and collected by the CFTC and acquired from the Exchange and other sources there was an emergency. *There was a high level of open interest relative to known or anticipated supplies of coffee deliverable under the December contract.* There was a concentration among a small group of traders both of positions to take delivery and of ownership of the known deliverable supply. Seventy-five percent of the open interest was held by three foreign traders. The deliverable supply on November 23 was estimated to be sufficient to cover only 200 contracts, while there existed 1132 open interest contracts.
>
> . . . .
>
> Effective as of the close of trading on Wednesday, November 23, the Exchange was ordered to limit trading in the December 1977 "C" coffee contract to liquidation only, and to direct and enforce the reduction of open interest on the following schedule:
>
> — Open interest as of the close of trading on December 2 was not to exceed 75 percent of the open interest as of the closing of trading on November 23.
>
> — Open interest as of the close of trading on December 9 was not to exceed 50 per cent [*sic*] of the November 23 open interest.
>
> — Open interest as of the close of tading [*sic*] on December 16 was not to exceed 25 percent of the November 23 open interest.
>
> — Open interest at the close of trading December 20 was not to exceed 10 percent of the November 23 open interest.

CFTC Advisory to the Media: Statement of CFTC Chairman William T. Bagley on the Ordered Liquidation of the December "C" 1977 Coffee Contract on the New York Coffee and Sugar Exchange 2-4 (Dec. 22, 1977) (emphasis added).

parties who have the commodity available to deliver.[126] Enough outstanding contracts should be mandatorily liquidated to restore a "safe" ratio of deliverable supply to open interest. Trading could then resume as usual until the "safe ratio" requires restoration. Such mandatory liquidations and resumptions of trading could occur repeatedly until the delivery month expires.

Because mandatory liquidation of contracts precludes delivery on those contracts, the shorts should bear some liability for any expenses incurred by the long as a result of the short's failure to deliver. However, if the long had no prior commitments for the certificated stock or if supplies were already owned beyond the long's prospective needs, no harm would result from liquidation of the contracts as opposed to delivery, and there would be no compensation. Furthermore, since a short hedger may enter the market not for any predetermined period of time but for as long as the hedger's cash position needs protection,[127] such a course may result in the hedger holding that position into the delivery month. Because one of the main functions of an exchange is to provide a protective mechanism for the hedger,[128] a hedger still holding in the delivery month to protect a cash position, rather than to reap speculative profits, should not be penalized.[129] In any case, the ceiling on the compensation that would be paid to the longs by shorts would be the added cost of importing deliverable supplies from a more remote location.[130]

Determining the need for mandatory liquidations should not be discretionary, as it is currently under regulation 1.41(f)(3)(i), lest the determination give rise to lawsuits by disgruntled traders forced to liquidate;[131] more important, a discretionary determination might never be made at all.[132]

To the extent that the necessary records are available, the

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[126] *See* 17 C.F.R. § 1.41(f)(3)(i) (1978). For text of this provision, see note 1 *supra*.

[127] *See generally* note 16 *supra*.

[128] *See generally id.*

[129] *See* 7 FTC REPORT, *supra* note 11, at 253.

[130] Otherwise the trader would obtain the stock elsewhere and deliver rather than pay the settlement price. *See generally* G.H. Miller & Co. Case, 15 Agric. Dec. 1015, 1046 (1956), *appeal denied*, 260 F.2d 286 (7th Cir. 1958), *cert. denied*, 359 U.S. 907 (1959); Great W. Food Distribs., Inc. Case, 10 Agric. Dec. 783, 808-09 (1951), *appeal denied*, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953).

[131] *See* note 120 *supra*.

[132] *See* notes 116-117 *supra* and accompanying text.

CFTC and the exchanges should compile statistics that disclose the ratios of deliverable supplies to open interests on those occasions when the rule has been implemented[133] and when known or suspected manipulations have occurred[134] in the past. These statistics should be supplemented with corresponding statistical data from emergency situations that develop over an appropriate number of months.[135] An analysis of these statistics would provide objective and consistent criteria for establishing reliable estimates of the points at which deliverable supplies are so diminished in comparison to volumes of open interest that the possibilities of delivery are "too remote." Likewise, daily application of such established estimates during the delivery month would provide objective and consistent criteria for identifying statistically safe ratios of deliverable supply to open interest for every commodity traded on every exchange.[136]

Traders should be afforded notice of the safe ratio as well as continuous notice of the prevailing ratio of deliverable supply to open interest for any given commodity during the expiring delivery month. This information would be the focal point from which necessary guidelines for prudent trading behavior could be inferred.

Compared to the imposition of penal sanctions, the preventive approach to corners and squeezes has several advantages. First, the preventive approach, by making criminal prosecutions of manipulative squeezes and corners obsolete, renders moot the question whether traders have sufficient notice of those elements of a corner or squeeze proscribed by the Commodity Exchange Act.

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[133] Exchanges commonly maintain such records. *See, e.g.*, Lagorio v. Board of Trade, 529 F.2d 1290, 1292 (7th Cir. 1976) ("In the case at hand, an affidavit by the president of the Board lists nine instances between 1936 and 1955 in which the Board took the same action it took here, and additional instances in which it allowed liquidation sales only.").

[134] A manipulation might be suspected where the cash price of a commodity at the delivery point temporarily rose relative to the commodity's cash price elsewhere (due to its control by the dominant longs, as in a corner, or its temporary unavailability, as in a squeeze), and then dropped back into line with the prevailing cash price at the end of the delivery period. *See* Hieronymus, *supra* note 74, at 53-55.

[135] The period of time for which such statistics should be collected would vary depending upon the commodity and the speed with which a sufficiently representative compilation of statistics can be acquired. The judgment of what constitutes a "sufficiently representative compilation" would be left to the exchange, the Commission, and their experienced statisticians.

[136] Those commodity futures most susceptible to delivery-month congestion or manipulation would be the first to yield the statistics necessary for determining safe ratios. Conversely, those commodity futures least susceptible to delivery-month congestion or manipulation would be the last to yield such statistics.

Second, the current practice of disciplining longs necessarily comes after the fact; the distorted price has already adversely affected market operation.[137] Subsequent sanctions merely punish manipulators; they cannot prevent manipulation. In contrast, mandatory liquidation of open contracts until the safe ratio is restored prevents manipulation from occurring.

Third, if the squeeze or corner is expertly effectuated, it may not engender the gross distortions in price that incite complaints,[138] yet nevertheless may impede performance of the market's basic functions.[139] However, the safe-ratio method of controlling squeezes and corners would prevent even those manipulations otherwise too subtle to incite litigation.

Fourth, the safe-ratio method makes no attempt to allocate blame for the manipulation. Punishing longs for an evil that frequently occurs with the voluntary involvement of the shorts is inequitable. Price distortion is often as much a result of shorts overstaying the market—expecting longs to sell their holdings to avoid taking delivery—as it is a result of longs standing for delivery to panic unprepared shorts into paying a higher price to offset their contracts.[140] Furthermore, punishing only longs after a manipulative squeeze or corner actually *encourages* shorts to hold their positions too long by giving them reason to believe longs will capitulate and liquidate early rather than face possible penalties for market manipulation. When it is erroneous, this prognostication by shorts works in a circular fashion, reinforcing the framework for manipulation. Because the system proposed here does not allocate blame, this kind of excessive speculation in the delivery month would be curbed.

Finally, this proposal would deny the longs any hope of dictating the shorts' liquidation price, thereby removing the incentive for cornering the market. On the other hand, the prospect of the shorts having to defend their trading behavior to minimize their liability to the long would deter the shorts from overstaying the market.

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[137] *See* text accompanying note 21 *supra*.

[138] Sometimes a "rise" in price can be hidden by not asking a price at the end of the month as high as obtained earlier in the month, and, in turn, selling short in a future month and using the accepted deliveries from the squeezed month to deliver on the short sales. Thus, the profit will not be determined by the degree of price rise in the squeezed month but from the relative difference in prices effected by the spread between the near and future months. *See* Comment, *supra* note 39, at 100-02. *See generally* Great W. Food Distribs., Inc. Case, 10 Agric. Dec. 783 (1951), *appeal denied*, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953).

[139] *See* note 24 *supra*.

[140] *See* text accompanying note 74 *supra*.

Professor Hieronymus suggests that any processes that "reduce the extent to which the full forces of competition are allowed to work themselves out in price formation" will weaken the market's integrity.[141] Such notions falter, however, when, as with a successfully cornered or squeezed market, shorts are at the mercy of overwhelmingly strong longs. Unrestrained competition in the commodity futures market is desirable only to the extent that it preserves the integrity of price formation. When free competition leads to the total disintegration of competitive trading ability, appropriate measures should be taken to neutralize any excessive advantage accruing to either side of the market.

CONCLUSION

The inefficacy of self-regulation by exchanges was a compelling factor[142] in the enactment of the Commodity Futures Trading Act of 1974 and continues to be a source of CFTC concern;[143] therefore, any regulation which authorizes an exchange to decide whether and how to deal with a squeeze or a corner is an anachronism.[144] Commodity exchanges need objective standards for identifying and preventing price manipulations through squeezes and corners during the delivery month. In developing and implementing such standards, however, the CFTC must be careful not to compound the problem. The CFTC should first conduct an empirical study to determine the effects of delivery-month trading disruptions on all market participants and the consumer public. Second, the CFTC should make use of all obtainable statistics to establish the frequency of these disruptions. Third, the CFTC should make a cost-benefit analysis of the safe-ratio method of preventing squeezes and corners and, in accordance with standard rulemaking procedure, solicit public comment on its potential consequences.[145]

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[141] Hieronymus, *supra* note 74, at 52.

[142] Then-Chairman of the House Committee on Agriculture W.R. Poage stated in 1974:

> On the floors of the exchanges where commodity futures are bought and sold there is little or no real security for the customer despite the inherent honesty of most brokers. Brokers, like many futures commission merchants, number among themselves the most honorable of men. Yet, there are also those who have been attracted to futures markets for their volatile environment and the hoped for ability to reap great profits in a hectic atmosphere . . . often times taking advantage of that atmosphere at the customer's expense. Again, because not all commodities are covered under the present Act, many attempts at self-regulation in those exchanges have been and continue to fail [*sic*]. Attempted investigations in regulated exchanges are often characterized by the unwillingness of the investigating committees composed of exchange members to inquire too closely into the possible excesses of their own brethren. In one or more unregulated exchanges it is continually charged that the owners of the exchange manipulate and evade the traditional rules for their own personal gain. Brokers, customers, and eventually the American ecomony suffers in this atmosphere of so-called "self-regulation" where tradition and self interest has been allowed to displace the public interest.

H.R. REP. NO. 975, 93d Cong., 2d Sess. 1, 38 (1974) (statement of W. R. Poage). *See also* note 116 *supra*.

[143] *See generally* note 116 *supra; see also* note 119 *supra*.

There is a widely held opinion that the most convenient method of dealing with delivery-month trading disruptions is for a trader who is not prepared to deliver or accept delivery to stay out of the delivery month.[146] However, there have been complaints that mechanical avoidance of the delivery month by traders who have no intention of making or taking delivery can reduce the efficiency of hedging, increase the hedger's risks, and result in higher commodity prices to the consumer.[147] Furthermore, since commodity exchanges were developed to accommodate traders, and not the reverse, notions of "solving" the market's functional problems through problem avoidance seem unpersuasive at best and could lead to dereliction of duty by traders, exchange personnel, and the CFTC—all obliged to free commodity futures markets of operational defects.[148]

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[144] For early criticism of the idea of allowing an exchange discretion over the enforcement of its own anticorner provisions, see 7 FTC REPORT, *supra* note 11, at 285:

> The chief evil of corners and squeezes is artificial price changes and price levels brought about by them. The need is prevention. . . . The question about which there is room for difference of opinion with regard to the anti-corner rule is not the moral and commercial soundness of the rule, but whether its administration solely by a committee on the exchange is the best practicable arrangement.

See generally note 113 *supra*. Although Professor Thomas Hieronymus criticizes suggestions for suspension of trading and fixed settlement prices, T. HIERONYMUS, *supra* note 6, at 327-28, he does concede that current rules may be in need of change. He states:

> Conceptually, the courts are not a good place to adjudicate manipulation. However, the mechanism of the CFTC is much worse. Prevention is the desirable solution, but it should be accomplished only in the rules. . . . Once the rules are made, the market should be allowed to trade out. If there are repeated congested expirations the rules should be changed.

Letter from Professor Thomas Hieronymus to the Author (Mar. 2, 1977) (on file in office of the *Hofstra Law Review*).

[145] *See* 17 C.F.R. § 13.4 (1978).

[146] Interview with John M. Schobel, Jr., Vice-President, New York Coffee and Sugar Exchange Inc., New York City (Jan. 4, 1979).

[147] *See* H.R. REP. NO. 975, 93d Cong., 2d Sess. 48 (1974). *See generally* note

Amendment of regulation 1.41(f) to provide mandatory liquidation of contracts, except for the delivery of the actual commodity, once the deliverable supply of a commodity falls below its safe ratio to open interest, should be given full consideration by the Commodity Futures Trading Commission. It may be the most predictable, impartial, and efficient means of freeing the commodity futures market from the deleterious effects of manipulative squeezes and corners.[149]

*Ralph T. Byrd**

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24 *supra*. Premature removal of a hedge due to fear of delivery-month disruptions results in incomplete protection for the hedger's cash position. *See generally* note 16 *supra*.

[148] *See, e.g.*, 7 U.S.C. § 5(d) & (g) (1976).

[149] Control of manipulation was a primary purpose for the development of federal regulation of commodity futures trading. *See* H.R. REP. NO. 421, 74th Cong., 1st Sess. 1-3 (1935); 80 CONG. REC. 6161, 6164 (1936); 62 CONG. REC. 9404, 9406, 9414 (1922). For a thorough discussion of early federal regulation of commodity futures trading, see Campbell, *supra* note 11; Rainbolt, *Regulating the Grain Gambler and His Successors*, 6 HOFSTRA L. REV. 1 (1977).

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C. "INTEREST RATE FUTURES," MARCELLE ARAK AND CHRISTOPHER J. McCURDY, FRBNY QUARTERLY REVIEW, WINTER 1979–80, PP. 33–46

Interest Rate Futures

On a typical day in 1979, futures contracts representing about $7½ billion in three-month Treasury bills changed hands in the International Monetary Market (IMM) of the Chicago Mercantile Exchange in Chicago. This market and several other new markets for interest rate futures have very quickly become active trading arenas. For example, at the Chicago Board of Trade (CBT), futures contracts representing $820 million of long-term Treasury bonds were traded on a typical day; also, at the CBT, futures contracts representing $540 million of GNMAs (Government National Mortgage Association securities) changed hands on an average day.

Besides these three well-established interest rate futures contracts, several new financial futures contracts have recently received the approval of the Commodity Futures Trading Commission (CFTC) and have begun trading. Futures contracts for intermediate-term Treasury notes commenced trading in the summer of 1979; in the fall, the Comex (Commodity Exchange, Inc.), which had traded many metals contracts, inaugurated a three-month bill futures contract, and the ACE (Amex Commodities Exchange, Inc., an affiliate of the American Stock Exchange) introduced a bond futures contract; in addition, the New York Stock Exchange is intending to start a financial futures unit.

What accounts for the rapid growth of interest rate futures? Who are the most active participants in these markets? Some businesses such as financial institutions and securities dealers use it to hedge or manage interest rate risk. By and large, however, participants are involved for other reasons and help provide much of the markets' liquidity. A large portion of the activity in these markets is speculative—people and institutions betting on which way interest rates will move and how the interest rate in one month will move relative to another. Others are involved in these interest rate futures markets for tax reasons.

Both the enormous size of these futures markets and the nature of the participants are a matter of concern for the regulatory authorities. The Treasury and the Federal Reserve System have become aware of potential problems for the functioning of markets in Government securities; these problems include the possibility of corners or squeezes on certain Treasury issues and the disruption of orderly cash markets for Treasury securities. In addition, the regulatory authorities have become concerned that the substantial numbers of small investors participating in the markets may not be fully aware of the risks involved.

What is a futures market?

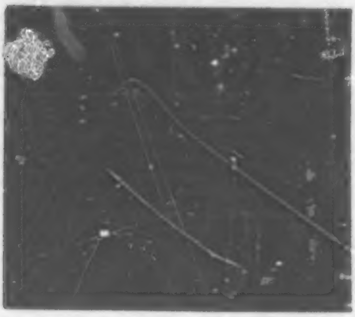
For as long as mankind has traded goods and services, people have made contracts which specify that commodities and money will change hands at some future date, at a price stated in the contract. Such contracts are called "forward" contracts. A forward contract tailored to one's needs offers obvious advantages—one can pick the exact date and the precise commodity desired. On the other hand, there are disadvantages. It may be difficult to locate a buyer or seller with exactly opposite needs. In addition, there is a risk that the other party to the transaction will default.

The authors wish to thank James Kurt Dew, Ronald Hobson, and Anthony Vignola for information and helpful comments. The foregoing do not necessarily agree with the views expressed herein, nor do they bear responsibility for any errors.

A futures contract is a standardized forward contract that is traded on an exchange. Usually the type and grade of commodity is specified as well as the date for delivery. Once a bargain is struck, the clearinghouse of the futures exchange itself becomes the opposite party to every transaction. Thus, it is the soundness of the exchange's clearinghouse rather than the creditworthiness of the original buyer (or seller) that is of concern to the seller (or buyer) on the other side of the transaction. To ensure its viability, futures exchanges and their clearinghouses set up rules and regulations. These include the requirements that a clearing member firm and its customers put up "margin", that the contracts be marked-to-market daily, and that trading cease if daily price fluctuations move outside certain limits.

Among the oldest futures markets in the United States are those for wheat and corn which date back to the middle of the nineteenth century. Thereafter, futures markets for other farm products and raw materials gradually developed. One of their major purposes was to provide producers and processors with price insurance. Suppose a farmer expects to harvest wheat in July. Nobody knows with certainty what the price will be then; it depends upon the size of the harvest and conditions elsewhere in the world. However, by selling a futures contract for July wheat, the farmer can indirectly guarantee receiving a particular price. This is illustrated in Box 1.

Futures markets for commodities not only provide a forum for hedgers, but they also provide information. This information—about prices expected to prevail on future dates—is printed in the financial section of many daily newspapers. The farmer, for example, can use these futures prices to decide whether to plant corn or wheat. The food processor can gear up to can corn or beans depending upon the expected prices and the prospective consumer demand at those prices.



Interest rate futures are a relatively new development. In the fall of 1975, the CBT inaugurated a GNMA contract. Shortly thereafter, in early 1976, the IMM introduced a contract for ninety-day Treasury bills and this was followed in 1977 by the CBT's Treasury bond futures contract. These three contracts—the CBT's original GNMA, the CBT's Treasury bond, and the IMM's three-month Treasury bill contract—have proved to be the most popular and heavily traded financial futures contracts. The amount of contracts outstanding, or open interest, in these markets has expanded significantly since their inception (Chart 1). Moreover, trading volume has also become quite large in relation to the underlying cash market securities. In 1979, daily average trading in the eight ninety-day Treasury bill contracts on the IMM was equivalent to about $7½ billion (at $1 million per contract), not much different from the daily volume of Treasury bills traded in the dealer market for United States Government securites.[1] Some interest rate futures contracts, however, have failed to attract much trading activity. For example, activity in the ninety-day commercial paper contract has remained quite light.[2]

How financial futures markets operate

The financial futures markets operate in the same manner as other futures markets. Their terms and methods are very different from those used in the money and bond markets. One of the most active financial futures markets is that for three-month Treasury bills at the IMM. Through this exchange, a customer could, for example, buy a contract to take delivery of (and pay for) $1 million of three-month Treasury bills on March 20, 1980. In all, there are eight contract delivery months on the IMM, extending at quarterly intervals for about two years into the future.

A customer places his order with a futures commission merchant—a firm registered with the CFTC and permitted to accept orders from the public—which

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[1] That market is described in "The Dealer Market for United States Government Securities", by Christopher McCurdy in this Bank's *Quarterly Review* (Winter 1977-78), pages 35-47.

[2] One of the problems with this contract has been that commercial paper issuers have at times tended to sell paper with maturities much shorter than ninety days. Also, because the paper of a large number of companies is deliverable against the contract, this generates substantial uncertainty about which paper will be delivered. In addition, the original technical specifications of the contract engendered some confusion.

[illegible] the order to the trading floor of the exchange. There, a member of the exchange enters the trading pit and announces his intention to purchase the March 1980 contract. Another member who has an order to sell that contract shouts out his offer and, if the two can agree on a price, the trade is consummated. The trading in the pit is by open outcry, which is typical of futures exchanges and very unlike the over-the-telephone negotiations in the cash market for Treasury securities.

The contract's price is quoted as the difference between 100 and the discount rate on the bill in question. Thus, a contract fixing a bill rate of 8.50 percent would be quoted at 91.50. This index preserves the normal futures market relationship in which the party obligated to take (make) delivery profits when the price rises (falls). The contract quote is not the price that would actually be paid for the bill at delivery. That price is computed by using the rate of discount in the standard bill price formula.

The clearinghouse interposes itself between the buyer and the seller, so that the buyer's contract is not with the seller but with the clearinghouse. (In the same fashion, the seller's contract is with the clearinghouse and not with the original buyer.)

A key ingredient in the financial viability of the clearinghouse is the margin that the clearing member firms must post on their contracts. For each outright purchase or sale of a three-month Treasury bill contract on the IMM, the firm must post margin of $1,200 per contract, which can be in the form of cash or bank letter of credit. The clearing member firm must, in turn, impose an initial margin of at least $1,500 on the customer. This may be posted in the form of cash, selected securities, or bank letters of credit. Futures firms can and often do require higher than the minimum margins of their customers. Margins formerly were more lenient, at one point down to $800 initial margin, but were raised following the greater volatility that emerged in the financial markets in the wake of the Federal Reserve System's policy actions in October 1979.

For as long as the position is outstanding, the contract will be *marked-to-market* by the clearinghouse at the end of each business day. For example, a clearing member with a long position in the March contract would have its margin account credited with a profit if the price rises, or debited with a loss if it declines. The prices used in the calculations are the *final settlement prices*, which are determined by the exchange by examining the prices attached to the trades transacted at the end of trading each day.

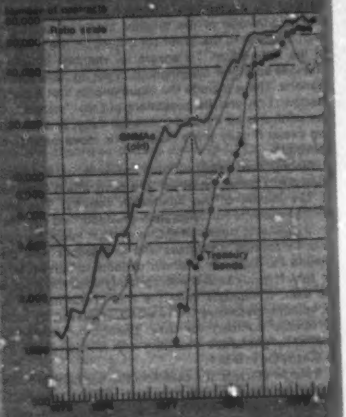
Profits in the margin account may be withdrawn immediately. When losses occur and reduce the firm's margin below $1,200, the firm must pay the differen to the clearinghouse in cash before trading opens the next day. It is permissible for the value of a custome margin account to fall below the initial $1,500 but, o the margin account falls below the $1,200 maintena margin, the account must be replenished in ful brought back up to $1,500. Since the value of a 1 ba point change in the futures bill rate is $25 per contr relatively small changes in interest rates can result large changes in the value of a margin account.

The exchanges impose rules that prices may change by more than a certain maximum amount fr one day to the next. At the IMM, for example, no futures trades may be cleared if the price is more th 60 basis points above or below the final settlem price on the previous day although, if the *daily*

Chart

Growth of Interest Rate Futures Markets: GNMAs, Treasury Bills, and Treasury Bonds

End-of-month open interest



See Box 2 for specifications.

Sources: International Monetary Market and Chicago Board of Trade.

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restricts trading for a few days, then wider limits may be imposed on subsequent days. Margins are often temporarily increased during such periods.

When the customer wishes to get out of his contract before maturity, he must take an offsetting position. To cancel the contract he bought, he must sell another contract. His order is forwarded to the pit and a sales contract is executed, but not necessarily with the party who sold it to him in the first place. Once again, the clearinghouse interposes itself between the two parties and the latest sale will be offset against the original purchase. The customer's overall position will be canceled, and the funds in the margin account will be returned to him.

The lion's share of all contracts traded are terminated before maturity in this fashion. Only a very small percentage of contracts traded is delivered. In the case of Treasury bills, delivery takes place on the day after trading stops. The customer who has sold the contract (the short) delivers $1 million (par value) of Treasury bills that have ninety, ninety-one, or ninety-two days to maturity, and the customer who bought the contract (the long) pays for the bills with immediately available funds. The price paid for the bills is the settlement price on the last day of trading. (With the daily marking-to-market, almost all losses and gains have been realized before the final delivery takes place.)

Variations in procedures exist on different contracts and exchanges, but they generally adhere to the same principles: open outcry trading, interposition of the clearinghouse, posting of margin, and daily marking-to-market. Box 2 delineates the key specifications on financial futures contracts. Probably the most important difference among contracts is that some allow delivery of a variety of securities. The active Treasury bond contract, for example, permits delivery of bonds from a "market basket" of different bonds, all with maturity (or first call) beyond fifteen years. This has the effect of substantially increasing the deliverable supply of securities but generates some uncertainty among those taking delivery as to which bonds they might receive.

The formal organizational structure of futures trading stands in contrast to the informal nature of forward trading. Dealers in the market for United States Government securities often agree to transact trades that call for forward delivery of Treasury issues. These trades are negotiated in the same fashion as trades for immediate delivery. There is no standardized contract as in the futures market: the two parties must agree to the specific security involved, the exact delivery date, the size of trade, and the price. These terms are set according to the mutual convenience of the two parties. Often, there is no initial margin and no marking-to-market to account for gains and losses. Thus, each participant must size up the creditworthiness of the other. Finally, these agreements, for the most part, are designed to result in delivery. (Some GNMA forward trades among a few firms can be offset through a clearinghouse arrangement.) If either side wishes to cancel the trade, it must go back to the other side and negotiate a termination.

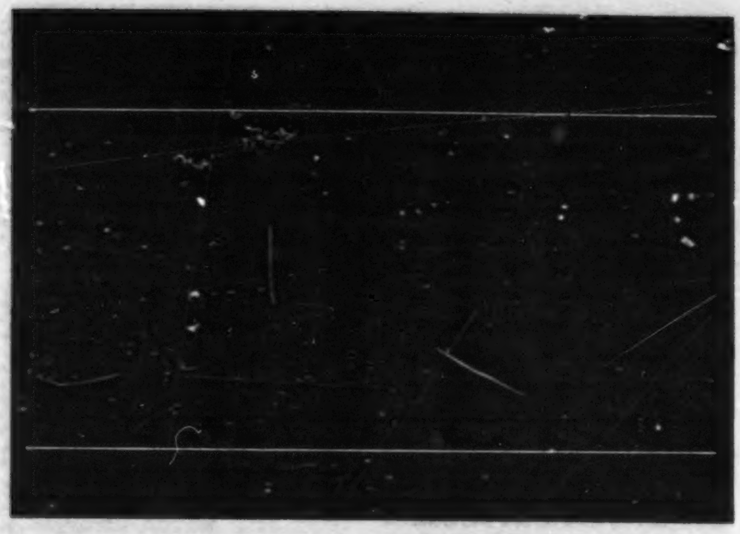
Participants in the interest rate futures markets

Many types of financial institutions participate in the markets for interest rate futures, but private individuals not acting in a business capacity account for the major part of interest rate futures positions in the three most active contracts (Chart 2).

According to a survey by the CFTC of positions outstanding on March 30, 1979, businesses other than the futures industry, commonly called "commercial traders", accounted for only about one quarter of open interest held in the most active contracts (ninety-day Treasury bills on the IMM, and Treasury bonds and the original GNMA contract on the CBT). In an earlier survey, such participants had held about three eighths of those contracts outstanding on November 30, 1977 (Table 1). The involvement of commercial traders is important because they are the only group that can use futures contracts for hedging cash market positions to any meaningful extent. (See next section.)

Moreover, some of the businesses who participate in these futures markets are probably not trying to eliminate risk completely. Consider securities dealers, for example, who have been very active in interest rate futures markets—they held about 7 percent of total GNMA positions and about 18 percent of total bond positions in March 1979. Securities dealers are generally risk takers, trying to benefit from interest rate change, or arbitrageurs, trying to benefit from interest rate disparities, rather than hedgers. But, in meeting customers' needs and making a market in Government securities, they do make use of interest rate futures markets to manage their risk exposure.

Among other business participants, mortgage bankers and savings and loan associations combined held about 7 percent of total positions in GNMAs. Their participation in GNMAs is to be expected in view of their involvement in generating and investing in mortgages. A total of sixty-eight of these firms held positions on March 30, 1979, not much above the number reported in the earlier survey. Few commercial banks have been active in interest rate futures—twenty-four had open positions in bill futures, and fourteen in bond futures on March 30, 1979—accounting for a small fraction of total positions in these markets. Their rela-



tively low level of participation may have reflected regulatory restrictions on their involvement in the futures market or some confusion about the regulators' policies.

Futures industry personnel and firms held a significant fraction of the open positions. This group includes many who are speculating on rate movements in general or on the spread relations between rates on successive contracts. Or they might be operating in both the cash and futures markets, arbitraging differences between the two markets.

Individuals and commodity pools—funds which purchase futures contracts—are very important participants in financial futures markets. They held almost half of the open positions in 1979, a substantial increase from their already significant participation in the earlier survey. Indeed, their 1979 share of total positions in financial contracts was certainly higher than that because positions of less than five contracts were not included in the second survey and individuals tend to hold the vast majority of such small positions.[3]

Services provided by interest rates futures markets

It is commonly believed that futures markets provide certain benefits—in the main, an inexpensive way to hedge risk and generate information on expected prices. Interest rate futures markets also provide these benefits.

Several observers have noted that interest rate futures markets are not necessary to provide information on future interest rates or as a hedging mechanism. They point out that one can obtain information

[3] Small positions in the bill futures contracts amounted to about 8,880 contracts at the end of March 1979 and thus would raise the combined share of individuals and commodity pools to a bit more than half of the bill futures market. Comparable calculations cannot be made for the CBT's bond and GMNA contracts because some small positions are posted on a net basis (*i.e.*, long positions are offset against short positions), compared with a gross basis as in the bill contracts.

[illegible] outstanding securities which have different maturities. However, the interest rate futures markets do provide future interest rate information in a more convenient form.

It is also true that outstanding securities could be used to hedge market risk. Again, however, the futures market can provide a less cumbersome and expensive hedge. Suppose, for example, that a firm is planning to issue short-term securities three months in the future and is worried about the prospective short-term interest rate. The short sale of a Treasury bill with more than three months to maturity is one way to hedge the risk.[4] In the futures market, the interest rate risk on this prospective issue could be hedged by selling the Treasury bill contract for the month closest to the prospective issue date. If all short rates moved up, the hedger would make a gain on the futures market transaction which would offset the loss on the higher interest rate he would have to offer.

Banks, dealers, and other such financial institutions may find futures markets helpful in achieving a particular maturity structure for their portfolios while having adequate supplies of cash securities on hand. For example, a dealer may need to hold supplies of a six-month bill to be ready for customer orders. However, he may not want the risk exposure on this particular maturity because he thinks its rate is likely to rise. Or, a mortgage banker may wish to hedge the risk on rates between the time of the mortgage loan and the time of its sale as part of a large package of loans. By selling a GNMA futures contract while assembling the mortgage package, the banker can be insured against rate changes. If rates rise, the value of the mortgage portfolio will fall, but that will be offset by the profits on the short sale of the GNMA contract. If, on the other hand, rates fall, the gain on the mortgage portfolio is offset by the loss on the sale of GNMA futures. In this hedge, the banker foregoes the possibility of additional profit (or loss) and is content to profit from the origination and servicing fees associated with assembling the mortgages.

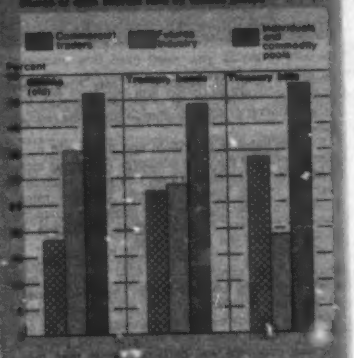
Not every financial transaction has an exact hedge in the futures market. When the cash asset is different from the security specified in the futures contract, the transaction is called a "cross hedge" and provides much less protection than an exact hedge. For example, a securities dealer might find it profitable to buy some certificates of deposit (CDs) and finance them for one month. To protect against a decline (increase) in the price (rates) of CDs over the interval, the dealer might sell Treasury bill futures contracts, assuming the movements in bill rates and CD rates will be similar over the interval. So long as the rates move in the same *direction* the dealer will be protected at least to some degree against adverse price movements. It is conceivable, however, that the rates could move in opposite directions. Thus, a cross hedge is really a speculation on the relationship between the particular cash market security held in position and the particular futures contract involved. In a cross hedge, the participants cannot deliver the cash security against the contract, so there is no threat of delivery that can be used to drive the prices on the two securities back into line as the expiration date approaches.

In contrast to financial businesses, nonfinancial businesses and private individuals are less likely to find a useful hedge in the interest rate futures market. Consider the typical nonfinancial business which is planning to issue securities to finance some capital

Chart 2

Futures Markets Participants, March 30, 1979

Shares of open interest held by various groups



Source: Commodity Futures Trading Commission.

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[4] The prospective issuer could borrow a six-month Treasury bill and sell it immediately. Three months hence he would buy a bill with the same maturity date to return. If interest rates for that future time interval rise, the security would be purchased more cheaply three months hence than is currently expected. The gain on this transaction would then offset the loss connected with issuing securities at the higher interest rate.

purchase or inventory. If the rate of inflation accelerates, the firm will typically be able to sell its output at higher prices. Thus, its nominal profit and return from the investment will typically also rise.[5] This means that a rise in inflationary expectations, which is reflected in the nominal rate of interest, will tend to affect profits in the same direction as it does financing costs. Thus, to some extent, the firm is automatically hedged against inflation-induced changes in the interest rate.

A similar intrinsic hedge may be available to investors on any new funds they plan to invest. Presumably they want to be sure that their investment produces a certain real income or purchasing power in the future. If interest rates move down because anticipated inflation has fallen, then the return on any funds invested at the lower rate will be able to buy the same quantity of goods and services that they would have in the circumstance where inflation and interest rates were higher. (The real return on *past* savings, however, will move in the opposite direction as inflation.)

Thus, to the extent that interest rate changes reflect revisions in inflationary expectations, many businesses and persons will not be in a very risky position with regard to saving or investment plans. If, as some contend, the variation in interest rates is largely connected with inflationary expectations, these groups would typically not obtain a very useful hedge in the interest rate futures market.

Speculation

While some participants use futures markets to hedge risk, others use them to speculate on price movements. Speculators like the high leverage obtainable and the low capital required for trades in futures markets relative to trades in cash markets. Speculation on interest rates could be accomplished in the cash markets but would typically involve greater costs than in futures markets. For example, suppose one thinks that the three-month interest rate in the June-September period will be higher than the implicit forward rate for that time interval. The short sale of a September bill in March and its repurchase in June can produce a profit if those high rates materialize. The costs involved in these transactions include the dollar value of the bid-ask spread as well as the charges for borrowing a security. In addition, one must have sufficient capital to put up collateral equivalent in value to the securities borrowed or the credit standing to borrow the securities under a reverse repurchase agreement.

In futures markets, one does not pay for or receive money for the commodity in advance. The cost of trading in the futures market is the foregone interest on the margin deposit (if in the form of cash) plus the commission fees. Assuming a $70 commission, this would amount to about $125 on a three-month bill futures contract at current interest rates, if the contract were held for three months. A change in the discount rate on the futures contract of 5 basis points would therefore recompense the speculator for his costs (Table 2).

Besides speculating on the level of rates, some futures market participants may be speculating on the relationship among interest rates. Such speculation can take the form of a "spread" trade whereby the participant buys one contract and sells another, hoping that the rate on the contract bought will fall by more than (or rise by less than) the rate on the contract sold. Also, if participants believe that the slope of the yield curve will change in a predictable way when the level of the yield curve changes, a spread transaction (which involves a lower margin) can be a less expensive way to speculate on the level of rates.

Frequently, traders will take positions in futures contracts that are related to positions in cash market securities. A trader might think that the rate in the futures market is out of line with cash Treasury bills. If he feels the futures rate is low relative to the rates

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[5] The firm does not, however, tend to earn nominal profits in proportion to prices because the tax structure collects more in real terms during inflation. See M. Arak, "Can the Performance of the Stock Market Be Explained by Inflation Coupled with our Tax System?" (Federal Reserve Bank of New York Research Paper).

on outstanding bills, he might sell the futures contract and buy the bills in the cash market. He could then carry the bill in position until the two rates move back to their more normal relationship. Then the bills would be sold and the short bill futures contract offset. These types of trades are often called "arbitrages" by participants in the cash market although they are not arbitrages in the strict sense in which a security is bought in one market and at the same time sold in another, thereby locking in an assured return. In fact, most arbitraging activity generally reflects speculation on the relationship between cash and futures rates.

Use of futures markets to reduce tax liability

Individuals and institutions have also used interest rate futures markets to reduce their taxes. One means was through spread transactions.

Until November 1978, spread transactions in the Treasury bill futures market were a popular means of postponing taxes. An individual would buy one contract and sell another, both for the next calendar year. For example, in 1976, the participant might have bought the March 1977 contract and sold the September 1977 contract. An important assumption was that interest rates on all contracts would tend to move together so that the net risk was relatively small. At some point before the end of 1976, whichever position had produced a loss would be closed out. (In the above example, the short position or the sale of the September 1977 contract was the item that showed a loss during the latter part of 1976.) That loss could then be deducted from other income for 1976, reducing the 1976 tax bill. The contract for March 1977, on which the gain had accrued, was not closed out until 1977 when it no longer affected the 1976 tax liability.[6]

What made Treasury bill futures particularly attractive for such spreads was the belief of many taxpayers that, just like actual Treasury bills, they were not capital assets. In contrast, it was clear that other types of futures contracts, not held exclusively for business purposes, were capital assets.[7] If Treasury bill futures were not capital assets, then losses on them could be fully subtracted from other ordinary income (providing that net ordinary income did not become negative). Capital losses, in contrast, could be subtracted from ordinary income to a very limited extent.[8]

This attraction of the Treasury bill futures market for tax postponement was eliminated in November 1978 when the IRS declared that a futures contract for Treasury bills is a capital asset if neither held primarily for sale to customers in the ordinary course of business nor purchased as a hedge.[9] Further, the IRS, amplifying on an earlier ruling,[10] stated that the maintenance of a "spread" position, in transactions involving futures contracts for Treasury bills, may not result in allowance of deductions where no real economic loss is incurred.

A way that individuals can reduce taxes through the futures market is by indirectly converting part of the interest income on Treasury bills into long-term capital gains. Suppose that the discount rate on a bill is expected to fall as it matures. Since the market usually regards longer dated bills as less liquid (or as having more interest rate risk), an investor would typically expect that a bill maturing in, say, March 1981 would offer a higher annual discount rate in June 1980 than it would in February 1981. Similarly, the interest rate on futures contracts would tend to fall as they approach expiration (their price would rise). Pursuant to the November 1978 IRS ruling, the price increase in a Treasury bill futures contract should, in nonbusiness circumstances, be treated as a capital gain for an investor. In contrast, since a Treasury bill itself is not a capital asset, all the price appreciation on it—from date of purchase to date of sale—would be treated as ordinary income for tax purposes.

An investor would clearly prefer to have the price appreciation treated as a long-term gain rather than as ordinary income, since the long-term capital gains tax rate is only 40 percent of that for ordinary income. If a long position in a bill futures contract were held for more than six months, the profit would be a long-term capital gain. (Gains and losses on short positions in futures are always treated as short-term regardless of the holding period.) Consequently, some investors who might normally purchase 52-week bills would have an incentive to purchase distant futures contracts and, as those contracts matured, sell them off to take their capital gains. They could then invest their funds in three-month bills. These activities would tend to raise the discount rate on the 52-week bill. It would also tend to reduce the required discount rate on distant futures contracts. Thus, the discount rates on futures contracts would be pushed below the implicit forward discount rate on cash bills.

There are, of course, limits on the size of the wedge that can be driven between the forward rate on cash securities and the rate on futures contracts. Financial businesses cannot treat profits in bill futures as capital gains. For them, the futures contract has no tax advantage over a cash bill. When the wedge produced by investors exceeds the cost of arbitrage, these financial businesses will buy long-term bills and sell futures contracts to profit from the disparities in rates.

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[6] After the September 1977 contract was offset, another contract for 1977 would be sold to maintain a balanced position. In our example, the June 1977 contract would be sold to counterbalance the March 1977 contract that was still being held. Then sometime in early 1977, these two contracts would be closed out.

[7] E.g., Faroll v. Jarecki, 231 F.2d 281 (7th Cir. 1956).

[8] Capital losses can be offset against capital gains with no limitation, but the excess of loss over gains that may be deducted from ordinary income in a single year is currently limited to $3,000.

[9] Rev. Rul. 78-414, 1978-2 C.B. 213.

[10] Rev. Rul. 77-185, 1977-1 C.B. 48.

Relationship between the cash and futures markets

For many commodities, the spot price and the futures price are very closely related. Part of the explanation is that, if a commodity is storable, it can be bought today, stored, and sold at a future date. If the futures price were to exceed the spot price by more than the costs involved, arbitrageurs would buy the commodity in the spot market—raising the spot price—and would sell it in the futures market, lowering the futures price. These activities would reduce the disparity between the future price and the current price.

The relationship between cash and futures markets for bills is somewhat different from that for other commodities. A three-month Treasury bill cannot be stored for more than three months; it matures. However, a longer term bill could be "stored" until it has three months left to run. It is the cash market for that *longer term bill* which bears a relationship to the futures market that is typical of agricultural and industrial commodities. In the case of note and bond contracts, the deliverable item exists throughout the life of the contract.

For example, consider what cash market securities correspond to the IMM's June 1980 three-month Treasury bill contract. This contract calls for delivery of bills which have ninety-one days to run on June 19, 1980. Treasury bills having this maturity date will be sold by the Treasury in two auctions—as six-month bills on March 17, 1980 and as three-month bills on June 16, 1980. During the first three months of its life, the six-month bill issued on March 20, 1980 is the commodity that could be "stored" for delivery on the futures contract.

The funds used to purchase the six-month bill when it is initially issued could have been invested in three-month bills which mature on the contract expiration date. One measure of the interest cost involved in storage is therefore the foregone interest on the shorter bill—this is the "opportunity cost" of the decision to invest in the longer bill which is deliverable on the futures contract. It is common to subtract that opportunity cost from the bill price to get the "forward" price and the corresponding "forward" rate; this rate can then be compared with the discount rate on the futures contract.

Because in the past only three-month and six-month bills matured on Thursdays, only bills originally issued as three-month or six-month bills could be delivered on a ninety-day bill futures contract.[11] In fact, at any date, there was only one bill issue in existence that could be delivered on an IMM bill futures contract. That particular bill had between three and six months to maturity and could be delivered on the closest three-month bill futures contract. For longer bill futures contracts, there was usually no exact correspondence. There is no cash bill in existence today that could be delivered on the September 1980, December 1980, March 1981, and subsequent contracts traded on the IMM. However, there are bills which have a maturity date that may be quite close. For example, the 52-week bill maturing on September 18, 1980 will have eighty-nine days to run on June 19, 1980, while the June futures contract calls for bills which have ninety to ninety-two days to run on that date. By comparing the rate on this 52-week bill with the rate on the 52-week bill which matures twelve weeks earlier, a forward rate which covers an interval close to that of the futures contract bill can be calculated. Through this method, a rough forward rate in the period nine months prior to the contract's expiration can be obtained.

How does the rate on a three-month Treasury bill futures contract compare with the implicit forward rate in the cash market? The futures rate on the June 1979 contract and the "forward" rate on the corresponding cash bill (which matured September 21, 1979) moved very similarly in the last ninety-one days before the futures contract expired (Chart 3). Typically, the spread between the two rates was less than 25 basis points, with the forward rate somewhat higher than the futures rate. On most other futures contracts for three-month Treasury bills as well, the futures and forward rates were fairly close in the last ninety-one days or so before expiration.

When the contract's expiration date was far in the future, however, the link between its rate and the comparable forward rate was much weaker. In fact, spreads between forward and futures rates have at times been over 100 basis points in the three to nine months before the contract expired. Generally, in recent contracts, futures rates have been substantially below forward rates, and the spread between the two appears to have been wider than it was in earlier contracts.

Within three months of the expiration of the futures contract, futures and forward rates appear to be kept in reasonable alignment by investors and arbitrageurs. An investor, for example, can on the one hand hold a six-month bill, or, on the other hand, hold a three-month bill plus the futures contract for the month in which the three-month cash bill matures. If the six-month bill is yielding more than the other combination, investors will tend to prefer six-month bills. And their demand will tend to reduce its discount rate, bringing the forward rate down toward the futures rate. Similarly, if investors find the three-month cash bill plus the futures contract more profitable, their buying pressure on the futures contract will tend to reduce its discount rate, bringing it down closer to the forward rate.

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[11] Now that the Treasury has begun to issue 52-week bills maturing on Thursdays, there will be some occasions on which bills issued as 52-week bills will be deliverable against the three-month bill contracts.

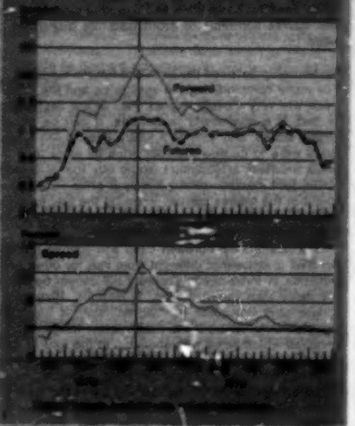
Another group of market participants who help keep rates in line are arbitrageurs. If they observe that the six-month bill provides a forward rate which is high relative to the futures rate, they could buy six-month bills and sell them under a repurchase agreement for three months;[11] at the same time, they would sell a futures contract. They would then have no net investment position: the bill returned to them in three months corresponds to the commitment to sell in the futures market. But they would earn a profit equal to the futures price minus the six-month bill price, the transaction cost, and the financing cost. As arbitrageurs conduct these activities, they put upward pressure on the six-month bill's price by buying it and put downward pressure on the futures price by selling the futures contract. These activities of the arbitrageurs usually tend to keep the forward and futures rates within certain bounds.

On contracts other than the nearest, however, there is no deliverable bill as yet outstanding—that is, no security exists that can be purchased, stored, and delivered against the contract. Consequently, arbitrageurs cannot lock in a profit by taking exactly offsetting positions in the two markets. If there is an order flow in the futures market that is persistent, sizable, and at variance with the prevailing view in the cash market, it is possible for speculators to drive a wedge between the rates on futures contracts and the implicit forward rates in the cash market.

One notable example occurred in the spring of 1979. Apparently, many small speculators purchased bill futures contracts due in mid-1980, in the belief that short-term interest rates had reached a cyclical peak and would begin to fall sometime within a year or so. From the end of April to the end of June, their holdings rose from about 25 percent to 35 percent of the total open interest and their net long positions expanded sharply. As a result of this buying pressure and purchases by those trying to get out of large short positions, rates dropped sharply, with the March 1980 and June 1980 contract rates falling by nearly 1½ percentage points from mid-May to the end of June. Rates also fell on contracts with shorter maturities—those due in the latter half of 1979.

Chart [illegible]

Discount Rate on the June 1979 Treasury Bill Futures Contract (IMM) and the Forward Rate in the Cash Market



Many other participants were net short, and some of these were firms that felt they were arbitraging between the cash and futures market, holding in this case long positions in the cash bill market against short positions in futures contracts. One of the several cash futures operations they engaged in was a long position in bills in the six-month area (i.e., due in November for the most part) versus a short in the September contract (calling for delivery of the bill to mature on December 20 which had not been auctioned yet). As the rates on futures contracts fell, those with short positions faced sizable margin calls. To the extent that they then bought futures contracts to offset their short positions and also sold their cash bills, they greatly enlarged the wedge that was being driven between the rates in these two markets in late May and early June (Chart 4).

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[11] A repurchase agreement specifies that the seller will rebuy at a prearranged date and price.

The widening wedge between the forward and futures rates made arbitrage involving futures contract sales even more profitable. But, after the shock of seeing large losses mount on short positions and show up in quarterly income statements, financial businesses were reluctant to expand their short positions. The futures and forward rates did not come back into alignment until late in the summer when interest rates started rising again.

Pros and cons of interest rate futures markets

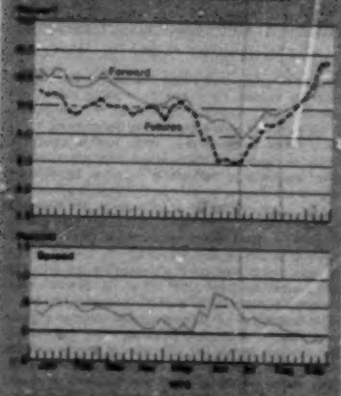
Many observers of the new financial futures markets argue that these markets permit investors to obtain flexibility in ownership of securities at a very low cost. Someone who expects to have funds to invest in the period from mid-June to mid-September 1980, for example, can lock in an interest rate by purchasing a June Treasury bill futures contract. (For those who plan to purchase or issue other securities such as commercial paper or CDs, the links between the movements of rates in the bill futures market and the rates that obtain on these other instruments can be weak.)

By transferring the interest rate risk to those most willing to assume it, interest rate futures may increase the commitment of funds for some future time intervals. This could reduce the premium attached to funds committed for that future interval relative to funds committed for the nearer term. For example, the yield on 52-week and nine-month bills might fall. The resulting greater liquidity represents a gain to investors, while the lower interest rate on Government debt reduces the taxes necessary to service that debt.

While the provision of hedging facilities is a desirable aspect of interest rate futures markets, much of the activity appears to be speculative, and this has created some concern. One such concern is that speculation in the futures markets might push the prices of certain Treasury bills out of line with the

Chart 4

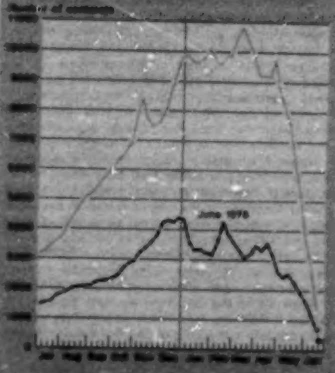
Discount Rate on the September 1979 Treasury Bill Futures Contract (IMM) and the Forward Rate in the Cash Market



Spread equals forward rate minus futures rate.

Chart 5

Open Interest in Treasury Bill Futures Contracts for June 1978 and June 1979



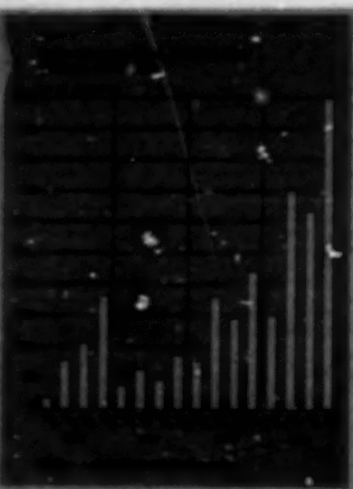
Weekly averages, week ending each Wednesday.
Total open interest as of last trading day
is indicated by dots.

Source: International Monetary Market.

[illegible] Because speculators [illegible] Consequently, entry into the futures market could be much more massive than entry into the cash market. Heavy demand in the futures market could be transmitted to the cash market by arbitrageurs. According to some analysts, the bill deliverable on the June 1979 contract was influenced by activities in the futures market. The June contract specified delivery on the Treasury bill due September 20 and only that bill. When the Treasury had sold $6.0 billion of bills with that maturity date, the Federal Reserve, foreign official accounts, and small investors held about one half. Thus, it appeared likely that the available trading supplies would amount to about $2 billion to $2½ billion.

However, open interest in the June 1979 contract stood at about 4,300 contracts, the equivalent of about $4.3 billion of bills at the end of May (Chart 5). This substantially exceeded the prospective trading supplies. During the spring, dealers reported that trading supplies in the September 20 bill were very thin and that it traded at a rate that was out of line with other bills. For example, it averaged about 4 basis points below the rate on the bill that was due a week earlier. Since investors usually require a higher rate when extending the maturity of their bill holdings, the 4 basis point difference provides a rough lower limit on the pressure that was exerted on the June contract and its spillover on the cash market.

Some observers argued that some investors were desirous of taking delivery because they thought there would be further declines in interest rates. Others pointed out that some people who had booked gains on long positions wanted to qualify for long-term capital gains. In any event, about a week before the contract expiration there was news of large increases in the money supply and industrial production which the market interpreted as indicating that a recession was not imminent and that interest rates would not fall immediately. This view probably contributed toward relieving pressure on the contract, and it was liquidated in an orderly fashion. Deliveries turned out to be a then record high of $788 million of bills due September 20, 1979, about a third of the available trading supplies of that bill. Deliveries on the September contract were somewhat lower, although still sizable (Chart 6), and deliveries on the December contract amounted to $1 billion.* Over the last month before delivery, the rate on the bill deliverable on the December contract averaged 6 basis points below the rate on the bill due one week earlier. As a result of these events, the question arises whether supplies of the deliverable bill are sufficient to prevent pricing distortions.



In contrast to bill futures, other futures contracts, notably in notes and bonds, have adopted a market basket approach to deliverable supplies. By allowing a variety of issues to be delivered, the contracts greatly reduce the possibility of a squeeze. If, for example, the September 13 bill had also been deliverable against the June contract, then traders would have had no incentive to deliver the September 20 bill at a rate that was below that on the September 13 bill. The mere availability of the other bill would therefore have provided a floor for the rate on the September 20 bill.

This analysis of bill futures has led some to suggest that, instead of a single deliverable issue, the deliverable security should be any one of a "basket" of Treasury bills with different maturity dates. However, others see disadvantages with the "basket" approach. In any event, the CFTC has authorized two new exchanges such as the ACE and the Comex to trade futures which involve bills maturing in a different week of the quarter than the IMM bill contracts. If these markets grow and become more active, there should be less likelihood of pressure on the one particular March, June, September, or December bill whose futures contract is traded on the IMM.

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* As part of the large volume of deliveries on the June 1979 contract, [illegible]

Finally, to many of the regulators, the size of the required margin deposit is a key issue. Larger margins would help insure the exchanges against possible defaults as well as discourage excessive speculation with little capital. Moreover, they might make participants more aware of the possibilities of loss inherent in trading in interest rate futures. In early October 1979, the minimum initial margin on Treasury bill futures contracts at the IMM was only $800, and a 32 basis point move in the rate on one of these contracts could have wiped out the entire margin. Now that margin is $1,500, which gives better protection to the exchange and the contract.

Concluding remarks

Interest rate futures markets have generated much new activity within a very short time; they have also generated some apprehension on the part of those concerned with orderly marketing and trading of the United States Government debt. Thus far, neither the extreme enthusiasm nor the worst worries appear to be justified.

Interest rate futures markets can provide inexpensive hedging facilities and flexibility in investment. But, to date, participation by financial institutions that might have such a need has not been large. Rather, it appears that participants have so far been primarily interested in either speculating on interest rates or reducing tax liabilities. These participants have been encouraged by fairly low margins. Until recently, the exchanges had shown a penchant for reducing these margins, but in October 1979 when interest rates fluctuated widely following the Federal Reserve System's adoption of new operating procedures, several exchanges raised margins substantially.

Most of the time, the financial futures markets have operated fairly smoothly. In general, there has been no greater volatility in the prices of bills which are deliverable on futures contracts than in the prices of other bills. And despite the huge run-up in open interest in some of the bill futures contracts, actual deliveries have not been large enough to disrupt the operation of the cash market. However, on several bill futures contracts, the price of the deliverable bill was pushed slightly out of line with prices on other issues with adjacent maturities. The CFTC, the Treasury, the Federal Reserve, and market participants themselves will have to continue to observe futures market activities to ensure that significant problems are not building up.

Interest rate futures markets have already provided an arena for some institutions to manage interest rate risk. And, as these markets mature, their economic usefulness may come to be more widely appreciated.

Marcelle Arak and Christopher J. McCurdy

D. "DEFINING MANIPULATION IN COMMODITY FUTURES TRADING: THE FUTURES 'SQUEEZE'," EDWARD T. McDERMOTT, NORTHWESTERN UNIVERSITY LAW REVIEW, VOL. 74, NO. 2, 1979, PP. 202-225

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DEFINING MANIPULATION IN COMMODITY FUTURES TRADING: THE FUTURES "SQUEEZE"

*Edward T. McDermott**

In these days of apparently irresistible inflation and sluggish economic growth, investors have been searching for new opportunities for profit in excess of the annual inflation rate. An increasingly popular investment opportunity for even small speculators has been the futures contract[1] whereby parties agree at a set price for the future delivery of a set amount of a commodity.[2] Despite this expansion[3] of futures trading, there are serious problems restricting even greater growth in the futures market.

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* B.A., Harvard, 1967; B.A., Cambridge, 1969; J.D., New York Univ., 1973; member of the New York Bar. The author would like to express his gratitude to all who have offered their comments on the article, but especially Janet McClendon and the people at Bon Pomme without whose assistance this article would not have been written.

[1] For an excellent description of the operation of a commodity futures exchange, see Volkart Bros. v. Freeman, 311 F.2d 52 (5th Cir. 1962). The common description of "futures contract" in the text is not totally accurate. The trader agreeing to make delivery (the "short trader") does not contract directly with the trader agreeing to take delivery (the "long trader"). Under the typical trading system the short trader in effect authorizes an exchange member, usually a futures commission merchant, to make a contract with a clearinghouse of the appropriate exchange for the making of delivery while the clearinghouse simultaneously contracts with a member, again a futures commission merchant, acting for a long trader agreeing to take delivery. Thus, the clearinghouse is obligated to take delivery from the short trader's futures commission merchant and promptly to make delivery with that commodity to the long trader's futures commission merchant. Whatever the inaccuracy of the description in the text, it is nonetheless adequate to describe and analyze "squeezes."

[2] Throughout this article the term "commodity" shall have the meaning set forth in the Commodity Exchange Act § 2(a)(1), 7 U.S.C. § 2(a)(1) (1976):

> [W]heat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions as provided in section 13-1 of this title, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in . . . .

See also Russo & Lyon, *The Exclusive Jurisdiction of the Commodity Futures Trading Commission*, 6 Hofstra L. Rev. 57, 58 n.3 (1977).

[3] Two common standards for measuring the growth of futures trading are the estimated dollar value of commodities traded and the number of contracts traded. In 1978, the dollar value was $2,122,069,764,590, an increase of almost 100% over the 1977 value. Futures Industry Association Bulletin No. 3803. During 1978 the number of futures contracts traded amounted to 58,4[illegible]2,172, a 36.3% increase over the 1977 volume. Futures Industry Association Bulletin No. 3884.

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The safeguards which government and the futures industry have placed over the personnel in the industry have sometimes proved inadequate.[4] More importantly, cautious investors, as well as exchanges and futures commission merchants, lack clear guidelines for protection from manipulative trading schemes. The controlling legislation, the Commodity Exchange Act,[5] prohibits "manipulation," without defining what manipulation is.[6] The legislation leaves the task of defining "manipulation" to the courts and the governing regulatory body, currently the Commodity Futures Trading Commission (CFTC).

Those institutions have made little progress toward defining manipulation.[7] Even the CFTC recently acknowledged "the apparent lack of objective standards for identifying and preventing potentially disruptive situations in futures markets."[8] Such an absence of objective standards stems in general from the courts' and the CFTC's adherence to a simplistic approach toward analyzing alleged manipulations at or near the end of trading periods. All too often they have blindly adopted antitrust concepts without any adjustments for the highly volatile nature of the futures markets. Other standards they have used have been ambiguous and misleading.

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[4] The most celebrated breakdown in the surveillance by government was the so-called Lloyd Carr affair. *See* Wall St. J., Feb. 23, 1979, at 8, col. 4.

[5] 7 U.S.C. §§ 1-22 (1976).

[6] Commodity Exchange Act § 6(b), 7 U.S.C. § 9 (1976), reads in pertinent part:

> If the [Commodity Futures Trading] Commission has reason to believe that any person . . . is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, . . . it may serve upon such person a complaint stating its charges in that respect, . . . requiring such person to show cause why an order should not be made prohibiting it from trading on or subject to the rules of any contract market, and directing that all contract markets refuse all trading privileges to such person, until further notice of the Commission, and to show cause why the registration of such person, if registered as futures commission merchant or any person associated therewith . . . . commodity trading advisor, commodity pool operator, or as floor broker hereunder, should not be suspended or revoked. . . . Upon evidence received, the Commission may prohibit such person from trading on or subject to the rules of any contract market and require all contract markets to refuse such person all trading privileges thereon for such period as may be specified in the order, and, if such person is registered as futures commission merchant . . . . commodity trading advisor, commodity pool operator, or as floor broker hereunder, may suspend for a period not to exceed six months, or revoke, the registration of such person, and may assess such person a civil penalty of not more than $100,000 for each such violation.

Commodity Exchange Act § 9(b), 7 U.S.C. § 13(b) (1976), provides:

> It shall be a felony punishable by a fine of not more than $100,000 or imprisonment for not more than five years, or both, together with the costs of prosecution, for any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any contract market . . . .

See also Commodity Exchange Act § 9(c), 7 U.S.C. § 13(c) (1976) (misdemeanor for violation of cease and desist order issued for manipulative activity prohibited by Commodity Exchange Act § 6(b), 7 U.S.C. § 9 (1976)).

[7] The definition of manipulation has not advanced beyond the point of ascertaining artificial prices in the cash and futures markets. *See, e.g.*, Board of Trade v. Olsen, 262 U.S. 1, 39 (1923); United States v. Patten, 226 U.S. 525, 539-40 (1911) (decided under the Sherman Antitrust Act, 15 U.S.C. § 1 (1976)); Cargill, Inc. v. Hardin, 452 F.2d 1154, 1163 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); Volkart Bros. v. Freeman, 311 F.2d 52, 58 (5th Cir. 1962); Great Western Food Distribs., Inc. v. Brannan, 201 F.2d 476, 482-83 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); General Foods Corp. v. Brannan, 170 F.2d 220, 231 (7th Cir. 1948); Vincent W. Kosuga, 19 Agric. Dec. 603, 618 (1960); Fox Deluxe Foods, Inc., 18 Agric. Dec. 582, 613 (1959); G.H. Miller & Co., 15 Agric. Dec. 1015, 1043-46 (1956), *aff'd*, 260 F.2d 286 (7th Cir. 1958), *cert denied*, 359 U.S. 907 (1959).

The purpose of this article is to suggest principles upon which a fair and effective definition of manipulation may be based. The focus is on the so-called futures "squeeze"—the classic and most famous form of manipulation. Stated in its simplest terms, the definition of a "squeeze" proposed in this article is: a trader's buying or threatening to take delivery of what it has already bought or owns. In more formal terms, a "squeeze" occurs when a long trader (the trader agreeing to take delivery) prevents or hinders a short trader (the trader agreeing to make delivery) from performing his contractual duty to deliver.[9] This prevention or hindrance of performance usually takes one of three forms: a long trader almost simultaneously buys the same commodity more than once; a long trader threatens to take delivery of the same commodity more than once; or a long trader buys what he already

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Unfortunately, commentaries on "squeezes" have generally accepted the premises of the conventional approach. *See, e.g.*, Comment, *Commodities: Futures Control: Manipulation Under the Commodity Exchange Act*, 57 MINN. L. REV. 1243 (1973); Comment, *Manipulation of Commodity Futures Prices—The* Great Western *Case*, 21 U. CHI. L. REV. 94 (1953) [hereinafter cited as CHICAGO Comment]; Comment, *The Delivery Requirement: An Illusory Bar to Regulation of Manipulation in Commodity Exchanges*, 73 YALE L.J. 171 (1963) [hereinafter cited as YALE Comment]; Comment, *Federal Regulation of Commodity Futures Trading*, 60 YALE L.J. 822 (1951). The sole exception, Hieronymus, *Manipulation in Commodity Futures Trading: Toward a Definition*, 6 HOFSTRA L. REV. 41, 46 (1977), also labeled the conventional analysis "simplistic." *See* note 66 *infra*.

[8] Proposed Limits on Positions Exceeding 25 Percent of the Open Interest in the Delivery Month of a Commodity Future, 43 Fed. Reg. 15,438, 15,439 (1978). Unfortunately, the CFTC did not propose any criteria for manipulation in that release. It merely proposed a regulation that would require an exchange to investigate a trader holding more than 25% of the open interest in a contract's last 15 days of trading to determine whether or not the trader's holding of that position would be likely to result in price manipulation or market congestion. *Id.* The CFTC's silence on the relevant criteria suggests a point argued in this article, namely the bankruptcy of the conventional approach toward understanding and defining manipulation in the form of a "squeeze."

[9] An example of the operation of the guideline may be helpful at this point. The operative definition is: a party prevents or hinders fulfillment of a contract and thus commits a manipulation to the extent that it knowingly purchases or threatens to take delivery of either the same commodity more than once or what it already owns. Thus, if the maximum deliverable supply is 500 carlots, a party already owning 200 carlots can purchase and retain futures contracts for no more than 300 carlots. If that party owns no carlots, it may purchase and maintain futures contracts for no more than 500 carlots. Otherwise, it is purchasing the same commodity twice and manipulating the futures and, perhaps, the cash markets. This guideline applies equally to situations where the deliverable supply cannot be increased at all and where the possible increase cannot make the deliverable supply equal to the position of the long trader.

owns. These manipulation schemes are designed to increase the futures and cash prices of the commodity for the benefit of the manipulator.[10]

THE CONVENTIONAL APPROACH

Judicial and regulatory efforts to define manipulation have centered on situations at or near the end of trading in a contract. The manipulation in those cases has generally assumed the form of a "squeeze." The prerequisites for finding such manipulation have been: a party's controlling long position in the futures contract; the party's control over the supply of the commodity deliverable for that contract; and the party's deliberate exaction of an artificially high price in the fulfillment or liquidation of the futures contracts.[11]

For the most part, such analysis has been so mechanical and unimaginative that the law governing manipulations has become an embarrassment—confusing, contradictory,[12] complex, and unsophisticated. The deficiencies are present in even the most widely cited and highly regarded opinions, *Cargill, Inc. v. Hardin*[13] and *Great Western Food Distributors, Inc. v. Brannan*.[14]

The Cargill *Case*

Cargill, Inc. v. Hardin featured a model "squeeze." In the middle of April, 1963, Cargill held the predominant share of the deliverable wheat supply for the May 1963 wheat futures contract traded on the

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[10] Some commentators and courts have differentiated between "corners" and "squeezes" on the ground that the latter is a less severe form of manipulation. *See* Cargill, Inc. v. Hardin, 452 F.2d 1154, 1161 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); Volkart Bros. v. Freeman, 311 F.2d 52, 59 (5th Cir. 1962); David Henner, 30 Agric. Dec. 1151, 1286 (1971); J. BAER & O. SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 83 (1949); Note, *Abuses in the Commodity Markets: The Need for Change in the Regulatory Structure*, 63 GEO. L.J. 751, 771 n.115 (1975); CHICAGO Comment, *supra* note 7, at 100. Others have used the terms interchangeably. H. EMERY, SPECULATION ON THE STOCK AND PRODUCE EXCHANGES OF THE UNITED STATES 175 (1896); Comment, *Reflections of 10b-5 in the "Pool" of Commodity Futures Antifraud*, 14 HOUS. L. REV. 899, 921 n.240 (1977). This article uses the latter approach since it is more consistent with the guidelines proposed. Moreover, while recognizing that a "squeeze" can be innocent and legal, *see* note 88 *infra*, this article generally uses the term "squeeze" to refer only to illegal or manipulative "squeezes."

[11] *See* cases cited in note 7 *supra* for cases adopting this approach.

[12] An issue which has divided courts is whether merely maintaining a current price is a form of manipulation. For a negative answer, see General Foods Corp. v. Brannan, 170 F.2d 220 (7th Cir. 1948). For an affirmative response, see David Henner, 30 Agric. Dec. 1151, 1227-31 (1970); Vincent W. Kosuga, 19 Agric. Dec. 603, 618-19 (1960); Fox Deluxe Foods, Inc., 18 Agric. Dec. 582, 613 (1959) (dictum), and cases and commentary cited therein. *See also* note 89 *infra*. *General Foods* is at best dubious authority, because it has been discredited by the other three decisions cited above.

[13] 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972).

[14] 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953).

Chicago Board of Trade.[15] It retained that dominant cash market share through the trading period. By the period's end Cargill owned virtually all of the deliverable supply, an amount far less than the open interest in the May 1963 wheat contract.[16]

In April, Cargill also built up a long position in the May 1963 wheat contract. With approximately one week of trading remaining, Cargill held a long position of nearly two million bushels.[17] It decreased that position only marginally in the days before the last day of trading. At the start of the last day, when Cargill owned almost all of the deliverable supply, its futures position constituted 24 percent of the open long interest.[18] It then made additional acquisitions of wheat contracts on the futures market. With only fifteen minutes of trading left, the price was $2.20 per bushel. At that moment Cargill placed orders to liquidate its contracts at specific prices just below the $2.28 5/8 price ceiling for that day.[19] The prices reached the limits specified by Cargill, with only seven minutes of trading time remaining when Cargill controlled approximately 62 percent of the long interest. The prices eventually reached the $2.28 5/8 ceiling, and Cargill ended the day's trading with holdings of long contracts of 365,000 bushels. The total open interest was 420,000 bushels.[20]

The Board of Trade supervised the liquidation of the open interest in the delivery period.[21] Cargill agreed to sell its wheat to short traders for $2.28 1/4 per bushel with provision for its delivery to Cargill. After this settlement Cargill still owned 88,000 bushels, which it sold for only $2.10 to $2.13 per bushel.[22]

The court upheld the judicial officer's findings that Cargill had established dominant positions in the futures[23] and cash[24] markets and had then exacted an artificially high price in settling its long contracts.[25] Then, relying on Cargill's experience in the futures market[26] and knowledge of both its control of almost all deliverable wheat[27] and its substantial position in the futures market,[28] the court also upheld the determination that Cargill had intentionally caused the "squeeze." In

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[15] 452 F.2d at 1159.

[16] *Id.* at 1160. Yet, in the delivery period Cargill apparently took delivery of 50,000 bushels from other sources (*i.e.*, 10 contracts). *Id.* at 1161.

[17] *Id.* at 1159.

[18] *Id.* at 1160.

[19] *Id.*

[20] *Id.*

[21] *Id.* at 1160-61.

[22] *Id.* at 1161.

[23] *Id.* at 1164.

[24] *Id.* at 1167.

[25] *Id.* at 1170.

[26] *Id.*

[27] *Id.*

[28] *Id.* at 1171.

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light of Cargill's conduct in the futures and cash markets, the United States Court of Appeals for the Eighth Circuit upheld the judicial officer's conclusion that Cargill had manipulated the futures market prices in violation of sections 9 and 13 of the Commodity Exchange Act.[29]

The Great Western *Case*

In *Great Western Food Distributors, Inc. v. Brannan*,[30] the United States Court of Appeals for the Seventh Circuit upheld a judicial officer's determination that Great Western had manipulated the prices of eggs in the cash and futures markets in violation of sections 9 and 13 of the Commodity Exchange Act. The court first examined Great Western's positions and transactions in the December 1947 egg contract traded on the Chicago Mercantile Exchange. Great Western's long position reached 256 contracts, 55.6 percent of the open interest, as of December 15, 1947.[31] By the end of trading on December 23, it had liquidated some of its long position but at a slower rate than other traders. Throughout that last trading week, Great Western held between 60 percent and 75 percent of the open long interest.[32] "Consequently," the Seventh Circuit concluded, "there can be no doubt of the propriety of the finding that Great Western acquired and maintained a dominant and controlling long position in December 1947 egg futures . . . ."[33]

The court also concluded that the evidence justified the finding that Great Western "controlled" the deliverable supply of eggs after December 15.[34] In early December it made heavy purchases in the cash market for eggs. As of December 17, the first delivery date, Great Western owned forty-nine carlots, 37.6 percent of the supply.[35] Once it began accepting delivery, its position steadily increased. On December 18, it held 43.9 percent of the egg stock, on the 19th, 48.5 percent, and on December 22, 51 percent.[36]

The Seventh Circuit then noted that the evidence demonstrated that the futures price for eggs was abnormally high in relation to the price of fresh eggs at the close of trading in the December 1947 contract. The price differential between fresh and contract eggs in December, 1947, was one-half cent per dozen at the close of trading, while the normal difference over the past fifteen years had been approximately four cents per dozen.[37] Moreover, whereas fresh egg prices dropped about seven and one-half cents per dozen during the last two weeks of trading, the contract eggs price first dropped only two and one-quarter cents and then rose again to a mere one-half cent lower than fresh eggs.[38]

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[29] *Id.* at 1172.

[30] 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953).

[31] *Id.* at 480.

[32] *Id.*

[33] *Id.*

[34] *Id.* at 481-82.

[35] *Id.* at 481.

[36] *Id.*

Finally, the court found the necessary manipulative intent in a statement of a Great Western official that Great Western had assumed its positions in the cash and futures markets in order, *inter alia*, to raise the price of the December 1947 contract.[39]

Analytical Deficiencies in the Conventional Approach

Cargill and *Great Western* share the same analytical deficiencies. The deficiencies fall into two categories. The first is the adoption of a framework only tenuously related to the actual characteristics of a "squeeze." In particular, its concepts fail to recognize fully the merger of the cash and futures markets at the end of a trading period. The second deficiency is the superficial use of those concepts to explain the operations of the cash and futures markets and a particular trader's activity in them.

The inadequacy of the conventional framework stems from its adherence to a distinction between the cash and futures markets at the very time when they are losing their separate identities. Courts using the framework generally acknowledge that the two markets are related.[40] They also acknowledge that prices in the two markets tend to converge.[41] Yet, they overlook the significance of the fact that, as the end of the trading period for a contract approaches, most distinctions between the two markets blur and the markets tend to merge.[42] Once the futures market becomes the present market, by definition, it is also a cash market. Use of this merged market as the starting point of the analysis of a "squeeze" is consonant with the actual operation of the commodities market and makes that analysis more subtle and probing.[43]

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[37] *Id.* at 483.

[38] *Id.*

[39] *Id.* at 484.

[40] *See* Cargill, Inc. v. Hardin, 452 F.2d at 1156-58; Great Western Food Distribs., Inc. v. Brannan, 201 F.2d at 478-79.

[41] *See, e.g.*, Board of Trade v. Olsen, 262 U.S. 1, 38-39 (1923); Cargill, Inc. v. Hardin, 452 F.2d at 1157. *See* 7 REPORT OF THE U.S. FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 248 (1926); 6 REPORT OF THE U.S. FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 125 (1925); T. HIERONYMUS, ECONOMICS OF FUTURES TRADING FOR COMMERCIAL AND PERSONAL PROFIT 152-54 (2d ed. 1977); CHICAGO COMMENT, *supra* note 7, at 98-99. Of course, there is no guarantee that the prices will converge. Knowledge of and interest in the activity in one market does not entail the same knowledge and interest in the other market. *See also* text accompanying notes 64-65 *infra*.

[42] The following example illustrates this point. In the last days of trading in a contract, a person may undertake a cash market obligation to deliver a commodity during the delivery period of that contract. Though he does not then own the commodity, he can take steps to satisfy his obligation by purchasing the requisite amount in the cash market or the futures market. At that time the prices on the two markets are probably similar, as the supply as well as potential purchasers and sellers of that supply are generally the same. For, even if a portion of the supply has not then qualified for delivery on the contract, it very likely can do so with very little difficulty. And, while some traders, especially floor brokers, speculators, and others without the facilities to make

Among the significant flaws falling in the second category of deficiencies is the superficial method of demonstrating that a long trader dominated the cash and futures markets. Both *Cargill* and *Great Western* focused upon isolated moments and then merely recited the position of the defendant at that time in one or both markets.[44] The analysis was indifferent to other market factors,[45] such as the composition or liquidity of the futures market at the relevant times, the number of transactions, the number of orders placed and yet not filled, the trading pattern, and the nature and positions of traders on the short side of the futures market.[46]

Given the conventional approach, scrutiny of such a wider range of market factors is essential to the process of discerning whether or not manipulation has occurred. The market in futures contracts frequently has no limits imposed by natural factors, such as deliverable supply. The open interest and volume of trading can expand or contract rapidly without any relation to the actual deliverable supply of a product. Initial costs of entry are frequently minimal.[47] A single transaction can radically alter the shape and composition of a market.[48]

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or take delivery, will not participate in the cash market, their participation in the futures market generally diminishes as the end of trading approaches.

[43] *See* text accompanying notes 69-123 *infra*.

[44] Cargill, Inc. v. Hardin, 452 F.2d at 1164; Great Western Distribs., Inc. v. Brannan, 201 F.2d at 481-83.

[45] One exception to this attack, G.H. Miller & Co., 15 Agric. Dec. 1015, 1023-24 (1956), *aff'd*, 260 F.2d 286 (7th Cir. 1958), *cert. denied*, 358 U.S. 907 (1959), provides some limited guidance. There the judicial officer listed the number and size of open short positions in the last week of trading to contrast respondents' conduct and concentrated power with the dispersed power on the short side. However, he did not probe the trading plans and operations of the short traders.

[46] Evidence of such factors may be difficult and costly to obtain. Yet, as noted in several antitrust decisions, it is frequently essential to examine the composition of the relevant market in order to determine whether or not a party actually had the ability to control prices in the market. *See generally* Winn Ave. Warehouse, Inc. v. Winchester Tobacco Warehouse Co., 339 F.2d 277 (6th Cir. 1964); Weber v. Wynne, 431 F. Supp. 1048, 1054 (D.N.J. 1977); United States v. Grinnell Corp., 236 F. Supp. 244, 254-56 (D.R.I. 1964), *modified*, 384 U.S. 563 (1966).

[47] T. HIERONYMUS, *supra* note 41, at 100. Speculators and at times hedgers must place "original" margin with a futures commission merchant for each contract purchased or sold. This usually amounts to a small percentage of the value of the contract. One writer has placed the value in the range of one percent to three percent. Melamed, *The Mechanics of a Commodity Futures Exchange: A Critique of Automation of the Transaction Process*, 6 HOFSTRA L. REV. 149, 167 (1977). Another has made an estimate of five percent to ten percent. T. HIERONYMUS, *supra* note 41, at 67, 250.

[48] The author is aware of a single transaction for the purchase and sale of 500 contracts at a time when the open interest was 5500. That transaction reduced the open interest substantially.

The open-ended structure of the futures market makes it especially misleading to conclude that merely a certain percentage of the open interest at a single moment or even selected moments automatically confers on a trader the power to "control" trading prices. Of all the courts' misconceptions about the futures markets, this is certainly the most ironic and perhaps the most inexplicable. The conventional approach tacitly assumes a slow static market. That assumption conflicts head-on with a frequent argument for the government's regulation of the futures markets, namely their complex, highly volatile, and unpredictable price fluctuations.[49]

Cargill and *Great Western* oversimplified the operations of the cash markets for the various commodities. Purchase and storage costs may seriously restrict entry. Yet, there is frequently no way to predict the size of the deliverable supply until the last few days of trading. Total supplies of the actual commodity usually do not set the operating limits on supply.[50] Normally, another qualification, such as certification, is required for inclusion of a quantity of the product in the deliverable supply.[51] Thus, there usually remains some uncertainty whether a trader can maintain or increase its share of the deliverable supply by not disposing of its holdings in the actual commodity.[52] Another party might obtain the necessary qualification before the end of the trading so as to dilute the first trader's share of the deliverable supply. And, since this qualification can frequently be obtained up until the last few days without the first trader's immediate knowledge, his "control" over a market can never be secure until then.

The courts' use of antitrust concepts for the cash market is also simplistic. In antitrust cases such control by a single party over prices has arisen from the party's monopoly of a cash market.[53] Almost every court has ascribed such power only to a party with seventy percent or more of the cash market.[54] Yet, when discussing the cash market for

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For a general description of the market's volatility, see Melamed, *supra* note 47, at 166-67. For a description of the liquidity of the futures markets, see *id.* at 155-60. *See also* T. HIERONYMUS, *supra* note 41, at 248.

[49] *See, e.g.*, S. REP. No. 1131, 93d Cong., 2d Sess. 13-19, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 5843, 5854-60.

[50] *See* Great Western Distribs., Inc. v. Brannan, 201 F.2d at 480-81.

[51] Case law provides numerous examples. *See, e.g.*, Volkart Bros. v. Freeman, 311 F.2d 52, 57 (5th Cir. 1962).

[52] The overlapping nature of these concepts—deliverable and actual supplies—makes an independent analysis of either questionable except at times when the deliverable supply cannot be increased to the level of the position of the long trader.

[53] *See, e.g.*, United States v. Grinnell Corp., 384 U.S. 563, 571 (1966); American Tobacco Co. v. United States, 328 U.S. 781, 796-98 (1946); Kansas City Star Co. v. United States, 240 F.2d 643, 663 (8th Cir.), *cert. denied*, 354 U.S. 923 (1957); United States v. Aluminum Co. of America, 148 F.2d 416, 429-30 (2d Cir. 1945).

[54] *See* cases cited in Hiland Dairy, Inc. v. Kroger Co., 402 F.2d 968, 974 n.9 (8th Cir. 1968), *cert. denied*, 395 U.S. 961 (1969). In Cliff Food Stores, Inc. v. Kroger, Inc., 417 F.2d 203, 207 n.2

eggs in isolation, the *Great Western* court concluded that the defendant had controlling market power, despite the comparatively moderate size of its holdings.[55] At no relevant time did Great Western hold more than fifty-one percent of the deliverable supply.[56] Thus, the court's summary ruling that Great Western controlled the deliverable supply is highly questionable.

No more satisfactory were the crucial determinations in *Cargill* and *Great Western* that artificial prices resulted from the respective defendants' positions in the cash and futures markets. The cases turned on totally irrelevant standards for determining artificial prices. The *Cargill* decision was based on four tests. First, the sharp price rise in the last two days of trading exceeded any price movement during the same period in the nine previous years.[57] Second, the increased spread between the May and July 1963 contracts in the last two days of trading was likewise unprecedented.[58] Third, the price relationship of the May 1963 contract in Chicago and its counterpart in Kansas City was "considerably out of line" as compared with the prior nine years.[59] Finally, the futures price did not bear a proper relationship to the cash price in May, 1963, especially on May 21, 1963.[60]

This analysis of Cargill's bargaining power in the cash and futures markets was conclusory and unpersuasive. The *Cargill* court sought guidance, first of all, in prior price relationships between the futures contracts under consideration and other contracts.[61] Mere abnormality in the relationship led the court to conclude that the contested price was artificial. That simplistic approach rested on the false premise that the prior prices serving as the measuring rod accurately reflected not only unmanipulated forces of supply and demand but, more importantly, the same or similar cost factors and forces of supply and demand present in the case before the court. For example, the emphasis in *Cargill* on the prices of the same contract in the previous nine years

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(5th Cir. 1969), the court deemed "something more than 50% . . . a prerequisite to a finding of monopoly." A court's definition of the relevant market will often be virtually determinative of the monopolization question. *See e.g.*, United States v. E.I. duPont de Nemours & Co., 351 U.S. 377, 425 (1956); Twin City Sportservice, Inc. v. Charles O. Finley & Co., 512 F.2d 1264, 1274 (9th Cir. 1975).

[55] 201 F.2d at 481. As this article demonstrates, *see* text accompanying notes 68-88 *infra*, it is possible to distort the futures market price with a futures position only and no position in the cash market. At least one commentator has failed to grasp this basic point. He has erroneously asserted that a manipulator in a "squeeze" "could not accomplish his purpose unless he eventually had *some* position in the cash market." Bianco, *The Mechanics of Futures Trading: Speculation and Manipulation*, 6 HOFSTRA L. REV. 27, 37 (1977) (emphasis in original).

[56] 201 F.2d at 481.

[57] 452 F.2d at 1167.

[58] *Id.*

[59] *Id.*

[60] *Id.* at 1168-69. The scarcity of cash market transactions made this standard questionable.

[61] *Id.* at 1167.

ignored changes in the structure and composition of the cash and futures markets. No less important, *Cargill's* focus on the sharp price rise ignored the fact that the utility of a market is often demonstrated in its ability to reflect changes in the forces of supply and demand in a swift, if stark, manner. Thus, the sharp price change highlighted by the court could have reflected unmanipulated as well as manipulated forces of supply and demand.

In *Great Western*, the Seventh Circuit was similarly unconvincing. The court relied on the skeletal evidence of former prices. It concluded that, inasmuch as the price "spread" between the December 1947 and January 1948 contracts was greater than the average of thirteen of the previous fifteen years, the December 1947 contract's prices were abnormal and evidence of manipulation.[62] Furthermore, while the usually higher price for fresh eggs at the close of trading in the December contract was maintained for the December 1947 contract, the price differential was smaller than usual. Those forms of price abnormality alone led the court to affirm the administrative court's determination that a price was manipulative. No consideration was given to the nature of the January 1948 contract's market or the possible changes in the market over fifteen years for fresh eggs and the December and January futures contracts.[63]

The foregoing demonstration of the inadequacy of former prices as standards suggests that a test of manipulation based ultimately on price comparison has very limited utility. No price constantly provides a satisfactory standard to determine whether another price is manipulated or not manipulated in the futures or cash markets. Reliance on former prices is a leap of faith, and the cash market price does not provide any guidance. As the two markets merge, the prices of the two generally become similar, if not identical, after adjustments are made for transport, quality, and other publicly known factors. In effect, each price usually operates as a magnet on the other. Thus, if either the cash or futures price has been manipulated, often the other price has been manipulated as well.[64] Ironically, in such circumstances reliance on the cash market price as the proper standard would lead to the holding that a manipulated price was *not* manipulated.[63]

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[62] 201 F.2d at 483.

[63] Nonetheless, at two points in *Great Western*, the Seventh Circuit did intimate superior methods of analysis for "squeezes." First, it noted that an explication of "comparative market conditions" in prior years was a prerequisite for use of prices from those years. *Id.* at 482. That insight was obviously more sophisticated than the analysis in *Cargill*. Second, it focused on the only relevant price relationship, the one between the cash and futures market prices at the close of trading in the contract. *Id.* at 483. However, instead of examining that relationship in December, 1947 in detail it merely compared the price relationship in December, 1947 with that of prior years. Reliance on the relationship between the prices of the cash and futures markets has serious deficiencies. *See* text accompanying note 65 *infra*. Nonetheless, it provides a standard clearly superior to former prices.

[64] Such pervasive, simultaneous manipulation occurs frequently when the quantities of the

PROPOSED GUIDELINE FOR A "SQUEEZE": BUYING OR THREATENING TO TAKE DELIVERY OF WHAT YOU HAVE ALREADY BOUGHT OR OWN

A judicial guideline for determining a "squeeze" and other forms of manipulation should be clear, flexible, simple, and reasonably comprehensive.[64] The guideline should reflect the nature of the economic

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actual and deliverable supplies are similar and limited in the last days before the expiration of the futures contract.

[63] In J.R. Simplot Co. v. New York Mercantile Exch., Inc., No. 76-3901 (S.D.N.Y. 1976), plaintiff made this argument to support its claim that it had been a victim of a "squeeze."

A second problem with relying on the cash market price as the proper standard is that no guarantee exists that the cash and futures price will become even similar. On occasion, economic factors, especially speculators' tardy liquidation of their open positions, cause a substantial disparity between prices in the cash and futures markets, which does not evidence a manipulation in either market. For example, see T. HIERONYMUS, *supra* note 41, at 341-42; U.S. Department of Agriculture Technical Bulletin No. 1119, Price Risks for Cotton and Cotton Products and Means of Reducing Them 27 (July 1955); U.S. Department of Agriculture Commodity Exchange Authority, The Cottonseed Oil Futures Market 30 (June 1949).

[64] Another commentator has found the judicial and regulatory decisions ambiguous and confusing. In lieu of their approach he has proposed that the proper analysis is one which will "look toward those actions which should or should not be tolerated because of their effect on the price-formation and risk-management functions of the market." Hieronymus, *supra* note 7, at 43. He formulates the standard as follows:

> The principle, in effect, is that futures traders should be put on notice that they will be expected to honor their contract commitments to buy and sell, and that there will be no intercession unless *commerce in the commodity is affected.*
>
> Under this principle, the judgment whether a price was distorted would go to the cash price of the commodity and to the flow of the commodity to and from the delivery point. A finding of long-side manipulation would be appropriate where the cash price of the commodity at the delivery point was higher than it would have been under *ordinary forces of supply and demand*, so that more than [an] *economically necessary* amount of the commodity was moved into delivery position. A finding of short-side manipulation would be appropriate where the cash price of the commodity at the delivery point was lower than it would have been under the *ordinary forces of supply and demand*, and where the stocks that were moved into delivery position were returned to the deliverers and had to be moved out at a loss. The principle would tolerate the free interplay of forces in futures with their accompanying gains and losses, as long as the cash price was not disturbed.

Id. at 53-54 (emphasis added).

This approach offers no major improvement over the conventional approach. The concept of "ordinary forces of supply and demand" stems from the same misunderstanding of the economic marketplace described in the judicial discussions of "abnormal" prices. *See* text accompanying notes 44-63 *supra*. This approach also uses ambiguous criteria, such as "economically necessary" and "unless commerce in the commodity is affected."

More importantly, this approach employs misleading concepts. There is often no sign of a short-side manipulation where the long trader accepting delivery has to resell the commodity delivered at a "loss." In fact, such a loss could just as well signal a long-side manipulation. *See, e.g.*, Cargill, Inc. v. Hardin, 452 F.2d at 1161; Fox Deluxe Foods, Inc., 18 Agric. Dec. 582, 593-94 (1959). For instance, if the settlement price for trading in a contract was $10, but the cash market price for the comparable commodity was only $8 and remained at $8 throughout the delivery period, then a long trader who received delivery and later resold the goods to the short traders at the cash market price would suffer a loss of $2. The price discrepancy between the futures and transactions in order to increase the efficiency of marketplace operations. Furthermore, it should not run seriously afoul of current notions of justice.

Construction of such a judicial guideline requires recognition of the merger of the futures and cash markets into one market.[67] An understanding of the nature of the economic transactions which constitute a "squeeze" is also essential. In the model "squeeze" situations, such as *Cargill*, the long trader engages in unjustifiable economic transactions as the cash and futures markets are merging. In effect, the long trader buys or threatens to take delivery of the same product twice. In buying the commodity in the cash as well as futures markets, or merely in the futures markets, it buys or threatens to demand delivery on what it has already bought or owns. The purchase or threat to take delivery after ownership has been secured serves no purpose except, of course, to hinder or prevent performance and inflate prices to the benefit of the long trader on its resale. As such, it is not a bona fide transaction.[68] Indeed, it undermines the purposes of the market in which it occurs, futures or

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cash markets could be due to a long-side manipulation in the futures market to keep the futures price inflated above the cash price.

In addition, the Hieronymus guideline omits circumstances already recognized as a "squeeze" in one of the reported court decisions. *See* Cargill, Inc. v. Hardin, 452 F.2d at 1160-61. Its depiction of a "squeeze" as the movement of "a more than economically necessary amount of the commodity" into delivery position, Hieronymus, *supra* note 7, at 54, does not cover a "squeeze" where no significant portion of the commodity is actually moved or transferred, but the parties simply liquidate their outstanding contracts at artificial prices dictated largely by the long trader which had always possessed the commodity. Indeed, what invites a long trader to conduct a "squeeze" is a situation in which it can own contracts for which actual delivery cannot be made with products outside its control or ownership.

[67] *See* note 42 and text accompanying notes 40-42 *supra*.

[68] This understanding of the transactions in a "squeeze" describes a form of futures trading which has frequently been labelled a manipulation, namely "wash sales." In the most common form of "wash sales," the party or parties involved engage in transactions where they buy and sell the same contracts. These trades do not involve a change in ownership of the product and thus constitute fictitious transactions. *Willard E. Platt*, 24 Agric. Dec. 93 (1965); *Irwin M. Eisen*, 22 Agric. Dec. 738 (1963); *Julian M. Marks*, 20 Agric. Dec. 457 (1961); *Perry & Co.*, 13 Agric. Dec. 597 (1954); *Thomas Jordan & Co.*, 7 Agric. Dec. 381 (1948); *Jean Goldwurm*, 7 Agric. Dec. 265 (1948).

The same appraisal fits the classic "squeeze," whether it takes the form of simultaneous purchases in the cash and futures markets or a purchase of more contracts than the deliverable supply. For, assuming that no contract remains open at the end of the delivery period, each logically results in a series of transactions where during the delivery period the long trader transfers his ownership of the *delivered* product *only* on the understanding, implicit or explicit, that the ownership of the product shall be returned to him. Given that understanding, it cannot be argued that any real change in ownership actually takes place in a "squeeze" involving a delivery.

There is another similarity between the transactions in "wash sales" and "squeezes." Both require the mind to accept an illogical set of assertions. "Wash sales" involve a person's simultaneous purchase and sale of the same goods. Yet, a person cannot buy what he is then selling. Likewise, it is illogical to say a person is buying what he already owns or has bought. In sum, both forms of economic activity serve no economic function and embody a logical contradiction.

cash. Such a transaction would thus seem a prima facie form of manipulation.

Assistance from the Common Law: The Principle of Prevention or Hindrance

The legal rule which incorporates this understanding of the relationship between the markets and the economic transactions in a "squeeze" and prohibits the unnecessary transactions is the established common law principle that a party who prevents or hinders another party from fulfilling his contractual obligation excuses the party from that obligation and is liable to him for the damages.[69] The Restatement of Contracts sets forth this principle, along with two exceptions:

> § 295. Excuse of Condition By Prevention or Hindrance.
>
> If a promisor prevents or hinders the occurrence of a condition, or the performance of a return promise, and the condition would have occurred or the performance of the return promise been rendered except for such prevention or hindrance, the condition is excused, and the actual or threatened nonperformance of the return promise does not discharge the promisor's duty, unless
>
> (a) the prevention or hindrance by the promisor is caused or justified by the conduct or pecuniary circumstances of the other party; or
>
> (b) the terms of the contract are such that the risk of such prevention or hindrance as occurs is assumed by the other party.[70]

Among the more famous of the countless cases illustrating this principle are *Patterson v. Meyerhofer*[71] and *United States v. Peck*.[72] In *Patterson*, Meyerhofer agreed to buy from Patterson several parcels of land for $23,000. She knew that Patterson did not then own them but that he planned to purchase them at a foreclosure sale.[73] She attended the sale and succeeded in buying the parcels of land for $22,380, $620 less than the sum they had agreed upon.[74] Patterson also made bids at the sale but was outbid by Meyerhofer. He then brought an action seeking, *inter alia*, the $620 difference between the contract price and the purchase price at the foreclosure sale. The court of appeals reversed a lower court's directed verdict for the defendant and ordered that a new trial be granted. Its reasoning began with "the general rule that a party who causes or sanctions the breach of an agreement is thereby precluded from recovering damages for its nonperformance or from interposing it as a defense to an action upon the contract."[75] Implicit in that rule, the court noted, was the understanding that Meyerhofer could not intentionally and purposely do anything to prevent Patterson from carrying out his promise to transfer to her the property.[76] Yet, she did so by outbidding Patterson for and assuming ownership of the land. Presumably, the court concluded, if she had not interfered, Patterson could have purchased the land for the same price and thus secured a $620 profit upon resale to Meyerhofer.[77]

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[69] No court or administrative official has adopted this guideline. Nonetheless, several opinions have contained intimations of it. For example, in Cargill, Inc. v. Hardin, 452 F.2d at 1167, the court's conclusion that Cargill had dominated the cash market rested in part on the finding that "the shorts could not fulfill their contracts, at least to the extent of 2 million bushels, without coming to Cargill for either the offsetting contracts or the warehouse receipts." Again, in discussing Cargill's control of the futures prices, the court noted that Cargill "was able to get these prices because there was nowhere else for the shorts to go to offset their contracts." *Id.* at 1170. In a similar vein, Fox Deluxe Foods, Inc., 18 Agric. Dec. 582, 594 (1959), noted that the respondent was able to demand and receive an artificial price for its eggs "only because it was the sole source of supply of deliverable eggs in Chicago at that time, and the short traders needed such eggs to satisfy their outstanding contracts."

[70] Restatement of Contracts § 295 (1932).

[71] 204 N.Y. 96, 97 N.E. 472 (1912).

[72] 102 U.S. 64 (1880). *See also* Kelly v. Fahrney, 123 F. 280, 282 (7th Cir. 1903); Carno v. Bassich, 187 A.D. 280, 280, 175 N.Y.S. 670, 671-72 (1919). The Uniform Commercial Code is also in accord with this procedure, *see* Uniform Commercial Code § 2-615, especially because of the inherent possibility of abnormal price increases in the futures markets. *But see* Maple Farms, Inc. v. City School Dist., 76 Misc. 2d 1080, 1085-86, 352 N.Y.S.2d 784, 790 (Sup. Ct. 1974). *See generally* Comment, *Contractual Flexibility in a Volatile Economy: Saving U.C.C. Section 2-615 from the Common Law*, 72 Nw. U.L. Rev. 1032 (1978).

United States v. Peck[78] presents a similar factual situation. Peck agreed to furnish hay to the military. Both parties understood that Peck would supply the hay from a specific area. When government officers feared that Peck would not furnish that hay, they allowed others to do so at an increased rate. They also attempted to deduct that extra amount from funds due to Peck for other services.[79] The court, in ruling on the admissibility of parol evidence of the parties' understanding that Peck was to furnish a specific supply of hay, noted the materiality of such evidence:

> [The evidence would show that] the conduct of the agents of the defendant by which the claimant was encouraged and led on to rely on a particular means of fulfilling his contract until it was too late to perform it in any other way; and then was prevented by these agents themselves from employing those means. The supply of hay which he depended on, and which under the circumstances he had a right to depend on, was taken away from the defendants themselves. In other words, the defendants prevented and hindered the claimant from performing his part of the contract.[80]

Hypothetical Application of the Common Law Approach.—The following hypothetical example illustrates the common law guideline's clarity and flexibility. *A*, a large entity in the cash market for soybeans, enters the last week of trading in the July soybean contract with a long position of 300 contracts. The total open interest at that time is 700 contracts. The known deliverable supply covers 600 contracts. Other soybeans can become part of the deliverable supply if they are stored in certain warehouses by the last day of trading. At the start of the last week, *A* owns enough soybeans in those warehouses to fulfill 100 of the 700 contracts.

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[73] 204 N.Y. at 98, 97 N.E. at 472.

[74] *Id.* at 99, 97 N.E. at 472.

[75] *Id.* at 100-01, 97 N.E. at 473.

[76] *Id.* at 101, 97 N.E. at 473.

[77] *Id.*

[78] 102 U.S. 64 (1880).

[79] *Id.* at 64.

[80] *Id.* at 65.

In the last week, *A* begins to buy more future contracts for soybeans while the open interest decreases. With three days of trading remaining, *A* is long 350 contracts when the open interest is 500 contracts. The deliverable supply aside from contracts owned by *A* begins to decrease. With three days of trading left, soybeans in the warehouses other than those owned by *A* cover only 375 contracts. Other soybeans are available outside of the warehouses, but the time required for their loading, transportation, and storage is greater than three days. Thus, the deliverable supply cannot be increased. It can only be decreased.

Under the proposed guideline, the conditions for a "squeeze" are present with three trading days left. The deliverable supply not owned by *A* is 375 contracts. *A*, with its 350 long contracts, has the right to take delivery on all but twenty-five of them. *A* is thus aware that purchases of more than twenty-five contracts may very well be manipulative and lead to a "squeeze."

It must also be wary of its current position. Merely maintaining it may lead to a "squeeze."[81] Thus, should *A* open the next-to-last day of trading with 350 contracts when the maximum deliverable supply of soybeans has decreased to 349 or fewer contracts, then *A* must begin to sell contracts to offset its long position, sell soybeans it owns to parties intending to keep the soybeans in the designated warehouses, or combine such sales. Otherwise, *A* will be engaging in a "squeeze," since it could demand to take delivery of what it already owned.

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[81] A premise of this guideline is *A*'s knowledge of or at least access to such information that would enable him to estimate the size of the deliverable supply. That such information may be slightly dated in the context of the trading in futures markets is insignificant. After and during the relevant time in this guideline, the deliverable supply cannot increase either at all or to the extent of *A*'s long position. Thus, *A* cannot expect that its position in excess of the deliverable supply can be satisfied by any means other than delivery of the same thing twice or settlement dictated largely by itself.

The concept of "deliverable supply" has had a central place in several decisions on manipulation. *See, e.g.*, Cargill, Inc. v. Hardin, 452 F.2d at 1165; Great Western Food Distribs., Inc. v. Brannan, 201 F.2d at 480-81. While a few other decisions have commented on whether the deliverable supply could have been increased at a specific time, *see* Volkart Bros. v. Freeman, 311 F.2d 52, 59-60 (5th Cir. 1962); G.H. Miller & Co. v. United States, 260 F.2d 286, 289 (7th Cir. 1958), *cert. denied*, 358 U.S. 907 (1959), none has dealt with the issue of the timeliness and public knowledge of information relating to the deliverable supply. It should be noted that the CFTC has the power both to collect and disseminate that information. Commodity Exchange Act §§ 16, 18, 7 U.S.C. §§ 20(a), 22(a) (1976). The U.S. Department of Agriculture disseminates reports on spot markets, such as potatoes. However, according to a recent report, General Accounting Office, Regulation of the Commodity Futures Markets—What Needs to be Done 115 (May 17, 1978), it has not yet refined its system to determine the quantity of deliverable supply for some commodities traded in futures markets. That task should be undertaken promptly to help prevent the occurrence of "squeezes."

Once *A* begins to reduce its position, it must make a significant effort to avoid a "squeeze" situation. The extent to which *A* maintains a long position in excess of the deliverable supply will usually be the extent to which it manipulates the futures and perhaps the cash markets.

That *A* manipulated the market merely by maintaining a long position in excess of the deliverable supply near the end of trading[82] may strike some as questionable. They will point out that when *A* purchased the contracts there was no foreseeable problem with the deliverable supply. Thus, they will argue it is not just to make *A* suffer for the insufficient deliverable supply. Rather, the short traders, with their obligation to make delivery, should bear the responsibility and, if necessary, the extra cost of delivery.[83]

This argument is not convincing. First of all, it ignores the key question: why would *A* demand delivery for more contracts than the deliverable supply can satisfy? Surely, it would not be to obtain the commodity, for there is not enough of the commodity to satisfy all its contracts. The sole reason would be to raise the futures price, and perhaps the cash prices, so *A* could benefit. That reason cannot justify *A*'s threatening to take delivery of the same thing twice.[84]

Second, this argument ignores the important difference between the cash and futures markets. Unlike traders in the cash market, the purchaser and the seller of a futures contract each retain the right to cancel its obligation without the approval of the other party to the contract.[85] Thus, when the situation outlined in this illustration arises, all the short positions on the specific contracts bought by *A* may very well have been liquidated a long time ago. Moreover, when the most recent contracts in excess of the deliverable supply were sold, short traders very likely were ignorant of not only the inadequate supply but also, given the mandatory secrecy of traders' positions,[86] the concentration of the long position under the control of *A*.

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[82] For a discussion of the case law in support of this contention, see notes 95-115 and accompanying text *infra*.

[83] It is no answer to contend that in such a situation the relevant exchange would have the power and duty to intervene in the trading and thus resolve the problem. This discussion, while not denying such power and duty to the exchanges, is directed at situations where the exchange has not taken action for various reasons, such as an excusable ignorance of the cash market holdings of the long trader. For a discussion of the powers of an exchange, see note 88 *infra*.

[84] As noted above, *see* text accompanying notes 62-64 *supra*, the criterion of "ordinary" forces of supply and demand suffers from its ambiguity. Yet, it is difficult to imagine a less "ordinary" combination of supply and demand than what is prohibited by the guidelines proposed in this article: a trader's purchase of or threat to take delivery of the same product more than once. Furthermore, if the long trader actually wants the commodity delivered, it will usually be able to purchase it in the cash market. As noted above, *see* text accompanying notes 50-51 *supra*, usually the deliverable supply is only a part of the total supply in the cash market.

[85] T. HIERONYMUS, *supra* note 41, at 31, recognizes that a futures contract differs from a normal purchase or sale of an actual commodity. However, he misrepresents a futures contract as an agreement to agree—"an agreement to later buy and sell a commodity." *Id.* That does not ex-

A final reason for imposing a duty on *A* to liquidate some of its contracts is its exclusive knowledge and power.[87] Of all the traders, only *A* knows that it controls long contracts for more than the deliverable supply of the commodity. Should short traders attempt to liquidate enough contracts to reduce the open interest to equal the deliverable supply, some cannot do so without falling subject to the dictates of *A*. Only with *A*'s cooperation can there be an elimination of the excess number of contracts.[88]

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plain why a seller is entitled to make delivery for a set sum from the moment his futures contract is executed. As the court in Volkart Bros. v. Freeman, 311 F.2d 52, 56 (5th Cir. 1962), noted:

> [T]he fundamental principle underlying all commodity exchanges is that a person who buys or sells a futures contract and does not offset it by a contra-transaction on the exchange must receive the commodity or be called upon to deliver it. The fact that most persons who trade on a commodity exchange expect to offset their contracts before the date of delivery or receipt is not a denial of this principle.

[86] This secrecy also affects the potential liability of any of *A*'s futures commission merchants. In normal circumstances one or more of them would have no liability if it or *A* did not liquidate *A*'s contracts in excess of the deliverable supply. Under the applicable Commodity Futures Trading Commission rules and regulations, it would not know the overall position of *A*. 17 C.F.R. § 17.00 (1978). Only *A* has to report that position to the CFTC pursuant to 17 C.F.R. § 18.00 (1978). Given the secrecy in which traders enshroud their activity and total positions, it is unlikely that any futures commission merchant would know or be able to estimate *A*'s overall position.

[87] The *Cargill* court recognized the significance of a trader's possession of such information. There Cargill alone knew of its ownership of almost all the wheat stored in Chicago at one stage. The court noted that "Cargill was thus in possession of a vital piece of information that other traders and grain dealers in Chicago did not have access to . . . ." Cargill, Inc. v. Hardin, 452 F.2d at 1159.

[88] Further explication of the guideline outlined in *Patterson* and *Peck* is found in the illustration to clause (b) of the Restatement of Contracts § 295:

> 3. A promises to sell and B to buy 1000 bales of hemp in six months from the date of the contract. B is buying hemp heavily from various sources, and in consequence A has difficulty in securing 1000 bales and the market price is largely increased. A is not excused from performing the constructive condition of tendering the hemp in order to subject B to a duty of immediate performance.

RESTATEMENT OF CONTRACTS § 295, Illustration 3 (1932).

A case bearing a marked resemblance to this illustration is Iron Trade Prod. Co. v. Wilkoff Co., 272 Pa. 172, 116 A. 150 (1922). Defendant there failed to deliver 2,600 tons of rails it had promised to plaintiff at $41 per ton. Defendant attempted to justify this failure by alleging that plaintiff's other purchases of rails reduced the already limited supply and raised the price so high as to make performance impossible. *Id.* at 174, 116 A. at 150. The court rejected that defense and awarded plaintiff as damages the difference between the contract price and what plaintiff paid to obtain the rails not delivered by defendant. *Id.* at 177, 116 A. at 151. The court pointed out that the defendant did not

> aver knowledge on [the] part of plaintiff that the supply of rails was limited or any intent on its part to prevent, interfere with, or embarass defendant in the performance of the contract; and there is no suggestion of any understanding, express or implied, that defendant was to

The Flexibility and Other Advantages of the Common Law Approach

The flexibility of the common law approach is illustrated in its explication of the diverse decisions which have ruled that a "squeeze" had taken place.[89] In *Cargill*, the defendant owned virtually all of the

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> secure the rails from any *particular source* or that plaintiff was to refrain from purchasing other rails . . . .

Id. at 174-75, 116 A. at 150-51 (emphasis added). Accordingly, the court reasoned that the case was governed by the rule that mere difficulty of performance will not excuse a breach of contract.

The court took pains to distinguish the case from *Peck*. There the plaintiff's purchases had exhausted the *same* supply of hay which it had agreed to buy from the defendant. No such prevention took place in *Wilkoff*. *Id.* at 175, 116 A. at 151. At worst, what happened in *Wilkoff* would amount to an unintentional "squeeze." As such, it would fit into the category of legal "squeezes" recognized by an official government report, 7 REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 243 (1926); by the courts, Volkart Bros. v. Freeman, 311 F.2d 52 (5th Cir. 1962); Great Western Food Distribs., Inc. v. Brannan, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); and by commentators, J. BAER & O. SAXON, *supra* note 80, at 82-83; G. HOFFMAN, FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS IN THE UNITED STATES 309-18 (1932). To date only one court, Volkart Bros., v. Freeman, 311 F.2d 52 (5th Cir. 1962), but no judicial officer, has ruled that an unintentional "squeeze" took place.

A second type of unintentional "squeeze" would occur when the total open interest exceeds the deliverable supply, but no single trader or group of traders controls a long position in excess of that supply. In such circumstances the exchange would have the discretionary authority to exercise its statutory power to limit or control trading. *See* Commodity Exchange Act § 5(a), 7 U.S.C. § 7(a) (1976); 17 C.F.R. §§ 1.41, 1.51 (1978). *See also* Cargill, Inc. v. Board of Trade, 164 F.2d 820 (7th Cir.), *cert. denied*, 333 U.S. 880 (1947); Daniel v. Board of Trade, 164 F.2d 815 (7th Cir. 1947).

However, the mere existence of an open interest in excess of the deliverable supply at any time in the trading period of a contract should not obligate an exchange automatically to exercise such power. Other factors, such as the amount in excess, the average daily volume of trading in the contract, the nature of the traders (speculators or hedgers), and the past pattern of liquidation would help the exchange determine whether or not to take any action.

The long traders would not be obligated to reduce any positions independently. Given the secrecy of the order in which open contracts would be delivered, no trader would have any reason to believe that it was responsible for the excess open positions. Nor would it know that it could not receive delivery on its contracts.

Another reason for imposing a duty on a long trader is the relatively dated public knowledge of the open interest. As recently noted by the CFTC, "[D]ata on positions and open interest at the close of a trading day may not be readily available until the following afternoon." 43 Fed. Reg. 15,438, 15,439 (1978). Since the information on open interest figures may thus be a day old, it does not inform a long trader at the time when it obtains this information whether its position exceeds the current open interest and whether it should liquidate any of its contracts.

[89] Complaints filed in various recent CFTC proceedings are also consistent with the common law approach. *See* Hugh P. King, COMM. FUT. L. REP. (CCH) ¶ 20,211 (1976); Tyson Foods Inc., Docket No. 75-13 (Opinion and Order dated Aug. 16, 1977); Plains Cotton Coop. Ass'n, Docket No. 75-11 (Opinion and Order dated July 15, 1977). *See also* Shief & Markham, *The Nation's "Commodity Cops"—Efforts by the Commodity Futures Trading Commission to Enforce the Commodity Exchange Act*, 34 BUS. LAW. 19, 36-37 (1978). However, all of these proceedings were settled by consent decrees.

However, the most recent CFTC complaint, Compania Salvadorena de Cafe, S.A., No. 79-34 (filed Mar. 12, 1979), appears to be at odds with the common law approach. The CFTC alleges that respondents manipulated the price of the July 1977 coffee futures contract toward the end of deliverable supply before the last two days of trading.[90] Thus, in building or increasing its already substantial long position—especially on the last day[91]—it was not only buying what it already owned but was also creating a situation where, as in *Patterson* and *Peck*, it was

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its trading period. Although the complaint does not use the term "squeeze" or "corner," it seems clear that the complaint attempts to depict such a situation. As such, the complaint appears incomplete. It focuses on only the percentage of the open interest held by the major respondent. It ignores not only the size of the deliverable supply but also the relationship between the cash and futures markets. Thus, it fails to demonstrate whether and, if so, how the long traders dominated and manipulated the futures or cash markets for coffee. In sum, this complaint seems to reveal a less satisfactory understanding of "squeezes" than even prior CFTC complaints.

This common law approach also makes no effort to reconcile the proposed guideline with General Foods Corp. v. Brannan, 170 F.2d 220, 231 (7th Cir. 1948). The court's ruling in *General Foods* that pegging or stabilizing, rather than inflating, a price in the futures market is not a manipulation has been effectively discredited. *See* discussion in note 12 *supra*.

On the other hand, the guideline is in accord with Volkart Bros. v. Freeman, 311 F.2d 52, 58 (5th Cir. 1962). *Volkart* has received serious criticism for its ruling that Volkart Brothers and its officials did not manipulate the futures market. *See* Cargill, Inc. v. Hardin, 452 F.2d at 1172-73; YALE Comment, *supra* note 7, at 178-80, 184. That criticism, while understandable in light of a mediocre opinion by the Fifth Circuit, is misconceived.

In *Volkart*, Volkart Brothers entered the last trading day with a long position twice the certificated supply for that month's cotton contract on two exchanges. It offered to close out its position at a price slightly above the prior day's closing price. *See* Volkart Bros., 20 Agric. Dec. 306, 328 (1961).

The Fifth Circuit dealt with the issue of manipulation clumsily. In effect, it ruled that the deliverable supply was not at its maximum at the start of the last trading day but could have been increased by short traders. Yet, it did not stress the amount of time—five days—allowed the short traders after the end of trading to increase the deliverable supply by purchasing cotton of a specified quality in the general cash market. The Fifth Circuit merely said:

> [W]e do not agree that the 1,250,000 bales of uncertificated cotton stored at ports designated as delivery points can be disregarded in determining the size of the available supply upon the simple finding that on October 15 the shorts did not have time to purchase the proper grade and class of cotton and secure its certification. . . . The petitioners can be held to a purpose to create prices not responsive to the forces of supply and demand only upon the assumption that the shorts should not be held to their contract obligation to deliver the cotton. Unless the shorts are to be excused from the performance of their contracts and from the exercise of due diligence to that end, the ample supply of uncertificated cotton must be considered as available to them.

311 F.2d at 59-60. That explanation has been attacked as inadequate. Unfortunately, the critics not only have ignored the significance of the fact that the deliverable supply was over a five-day, not a one-day, period, but also have misinterpreted *Volkart*. Contrary to those critics, *Volkart* never denied "the possibility of government regulation of squeeze situations . . . ." YALE Comment, *supra* note 7, at 178. Nor did it "preclud[e] judicial regulation of squeezes . . . ." *Id.* at 180. Nor did "the *Volkart* decision [hold] that manipulative squeezes are not prohibited by the Commodity Exchange Act." Cargill, Inc. v. Hardin, 452 F.2d at 1172. Instead, it stands for the ruling that where the supply could be increased and the short traders had enough time—five days—not only to increase, but also to make delivery with, that additional supply, a party with an open long position in excess of the certified supply at the start of the last trading day did not commit a manipulation when it offered to liquidate its position at a price slightly in excess of the prior day's closing price in the futures market.

[90] Cargill, Inc. v. Hardin, 452 F.2d at 1160.

[91] *Id.*

preventing or hindering the short traders from fulfilling their obligations under their futures contracts.

The facts of *Great Western* likewise fit the framework of *Patterson* and *Peck*. By the next-to-last trading day, Great Western held 119 long contracts, almost three-quarters of the open long position.[92] Yet, on that day it increased its share of the cash market's deliverable supply to over one-half of the 120 carlots. In other words, by the end of trading on December 22, 1947, to satisfy the 119 long contracts of Great Western, there were only fifty-nine carlots of eggs which Great Western had not already bought in the cash market.[93] On the last day of trading, December 23, 1947, it barely reduced its cash position or its futures position. It thereby hindered short traders from making delivery.[94]

G.H. Miller & Co.[95] provides another example. There respondents, with five days of trading remaining, held forty-six contracts for delivery of eggs in December, 1952,[96] when the egg stocks were comparatively low.[97] They also owned twenty-three carlots of eggs, almost 20 percent of the then deliverable supply.[98] Over the next three days they increased their long futures position by almost five times while simultaneously maintaining their holdings in the deliverable supply. By the end of that third day, their futures position almost tripled the deliverable supply outside their control.[99] In the last two days defendants changed their "squeeze" strategy. They exerted pressure by obtaining more and more of the deliverable supply while closing out some, but not all, of their long position.[100] By the end of trading their long position of sixty-six contracts was not only the entire long position,[101] but also much more than twice the deliverable supply outside of their control.[102] Not surprisingly, twenty-one contracts remained unfilled after the delivery period had passed.[103] In making those second purchases, respondents were preventing short traders from fulfilling their contractual duties.

This common law guideline for "squeezes" also covers cases featuring a long trader's establishment and maintenance of a futures position in excess of the maximum possible deliverable supply. There need not be any significant cash market purchases before the delivery period. For example, in *Fox Deluxe Foods, Inc.*[104] the respondent purchased December, 1953 egg futures contracts for itself and its customers in December, 1953. In the last few days of trading, their long positions far exceeded the supply of deliverable eggs, a fact known to the respondent.[105] On the last day Fox offered 198 of those contracts for sale at a price just below the maximum price permissible and above the price then charged in the cash market for eggs generally acknowledged to be of better quality.[106] As a result, ninety-six of Fox's contracts remained open after the end of trading.[107] Since that was not only the entire open long position interest, but also four times the deliverable supply of eggs,[108] it enabled Fox and the customers under its control to receive and own the entire deliverable supply while they still retained an open interest. Although this ownership occurred during the delivery period, it was foreseeable by the last day of trading, if not before, that Fox, by its futures purchases, had bought and was threatening to take delivery of the same supplies of the commodity twice.

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[92] Great Western Food Distribs., Inc. v. Brannan, 201 F.2d at 481.

[93] *Id.*

[94] *Id.*

[95] 15 Agric. Dec. 1015 (1956), *aff'd*, 260 F.2d 286 (7th Cir. 1958), *cert. denied*, 358 U.S. 907 (1959).

[96] *Id.* at 1021.

[97] *Id.* at 1038.

[98] *Id.* at 1025.

[99] *Id.*

[100] *Id.*

[101] *Id.* at 1039.

[102] *Id.* at 1025.

[103] *Id.* at 1031-32.

A second case featuring maintenance of an excessive futures position is *Peto v. Howell*.[109] Defendant there made heavy corn purchases through the July 1931 corn contract. By June 1, 1931, his futures position totalled about 8.4 million bushels.[110] One month later defendant still had that position, which was far in excess of the corn available for delivery on the July contract.[111] Defendant took delivery on his position. Almost one million bushels of the corn he received he sent to Canada away from those obligated to make delivery.[112] By the end of the delivery period Howell owned 97 percent of the deliverable supply.[113] Approximately one million bushels remained undelivered. Yet, only some 225,000 remained outside of his control for purchase by short traders.[114] With that excess number of contracts, Howell not only hindered delivery but also was able to obtain very high prices in settlement from those who could not deliver, such as Peto. Immediately after the delivery period, the price of corn fell sharply.[115]

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[104] 18 Agric. Dec. 582 (1959).

[105] *Id.* at 591.

[106] *Id.* at 590-91.

[107] *Id.* at 591.

[108] *Id.*

[109] 101 F.2d 353 (7th Cir. 1938). Howell also purchased an insignificant amount of corn in the cash market. That amount did not approximate the amount not delivered. The value of *Peto* as precedent on the issue of manipulation may be limited, for it is not clear whether the court indicated that Howell manipulated the futures market. Its ruling was under the Sherman Antitrust Act, 15 U.S.C. §§ 2, 15 (1976). 101 F.2d at 354. Yet, it also stated that "[p]laintiff relied upon" the definition of "manipulation" in the then-controlling legislation, the Grain Futures Act. 101 F.2d at 355. Furthermore, three courts have indicated that it featured a manipulation. Great Western Food Distribs., Inc. v. Brannan, 201 F.2d at 478, cited *Peto* for the proposition that purchases of futures contracts in excess of the known deliverable supply could amount to "manipulation." Another, Volkart Bros. v. Freeman, 311 F.2d at 59, indicated that in *Peto* a party's control of the actual commodity enabled it to convert a dominant futures position into an illegal "squeeze" or "corner." Cargill, Inc. v. Hardin, 452 F.2d at 1162 n.8, also cited *Peto* as an example of a "massive" and "successful" "corner."

[110] 101 F.2d at 356.

[111] *Id.*

[112] *Id.* at 355-56.

The second advantage of the common law approach is its ability to pinpoint when the "squeeze" began and ended. Reported decisions, with the possible exception of *Cargill*,[116] merely conclude that a "squeeze" occurred. No attention is given to the exact duration or time of the "squeeze." As long as actions alleging "squeezes" were mainly administrative proceedings, there was no special need to specify the time of a "squeeze." However, that need now exists with the increase in civil actions alleging "squeezes" and claiming substantial damages.

A third advantage of this set of guidelines is its wider scope. The common law approach covers many situations, especially immediately before or in delivery periods, both more and less disruptive to cash and futures markets than classic "squeezes." One party's failure to deliver on all or any of its contracts, except at artificial prices, can be caused by a variety of acts by the long trader far more subtle than outright purchase of the commodity. The long trader could rent or purchase storage space in the event, as in *Great Western*,[117] the commodity must be located at a specific point by a specific time for inclusion in the deliverable supply. It could induce others to refuse to sell for delivery. It could also monopolize the means of delivery if any transportation is required. Again, the long trader could knowingly disseminate false rumors to dissuade owners of the deliverable supply from selling their goods to short traders.[118] In effect, this approach prohibits the long trader's direct or indirect control over any of the conditions a short trader must satisfy.

A detailed illustration is provided by *Vincent W. Kosuga*.[119] There the respondents during the relevant time period came to own almost all of the available deliverable supply of onions.[120] They agreed along with numerous onion shippers and growers not to make any onions available for delivery on any onion contracts traded on the Chicago Mercantile Exchange.[121] They also had those shippers and growers agree to purchase from them 286 carlots of onions and to make those onions unavailable for delivery on any onion contract.[122] Absent such agreements, the judicial officer found that some or all of those onions would have been so delivered. In concluding that respondents attempted to manipulate the futures and cash markets in onions, the judicial officer stressed respondents' agreements among themselves and others to make onions unavailable for delivery.[123]

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[113] *Id.* at 356.

[114] *Id.* at 355-56.

[115] *Id.* at 356.

[116] In *Cargill*, the court found that a "squeeze" occurred specifically with 15 minutes of trading remaining. 452 F.2d at 1164.

[117] 201 F.2d at 480-81.

[118] Such interference in the performance of a contract has been alleged in litigation arising out of trading in the May 1976 Maine potato futures contract. J.R. Simplot Co. v. New York Mercantile Exch., Inc., No. 76-3904 (S.D.N.Y. 1976). Several cases have also featured actual or attempted manipulation caused by dissemination of false information. *See* Landon V. Butler, 14 Agric. Dec. 429 (1955); Ralph W. Moore, 9 Agric. Dec. 1299, *aff'd*, 191 F.2d 775 (D.C. Cir. 1950), *cert. denied*, 342 U.S. 880 (1951); Reuben E. McGuigan, 5 Agric. Dec. 249 (1946); 7 REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 258 (1926).

[119] 19 Agric. Dec. 603 (1960).

The fourth and final advantage may be the most important. The common law approach allows a far more probing, yet far less time-consuming and costly, analysis than does the conventional approach. Since it discards vague concepts like "dominant position" for an emphasis on objective factors such as trading figures, it helps traders, futures commission merchants, exchanges, and the CFTC analyze as well as anticipate actual and potential "squeezes." Lastly, to the extent it enables litigants and courts to focus on easily identifiable facts as evidence of the "squeeze," it reduces the costs of litigation.

CONCLUSION

This decade has witnessed an unexpected and unprecedented boom in the trading of futures contracts. Given the prospect of continuing inflation and stagnant economic performance, the public's interest in futures contracts will probably persist into the next decade. It may very well increase. To transform that interest into greater participation in the futures market, the courts, the CFTC, and the futures industry will have to take steps to minimize the uncertainty not inherent in these admittedly risky investments. One necessary initial step is the expression of a clearer, more comprehensive understanding of the most notorious form of manipulation, the "squeeze." That understanding will enable traders and futures commission merchants not only to foresee and avoid problems but also to conduct trading with increased certainty. It will also help exchanges to improve their market surveillance. And, in the end, it will enable all litigants to reduce the costs of litigation substantially.

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[120] *Id.* at 607, 612.
[121] *Id.* at 608, 616.
[122] *Id.*
[123] *Id.* at 616-17.